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No.

Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1978

UNITED STATES OF AMERICA, PETITIONER

v.

NEIL T. NAFTALIN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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United States of America, petitioner

v.

Neil T. Naftalin

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

The Solicitor General, on behalf of the United States, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, 1a-11a) is reported at 579 F.2d 444. The opinion of the district court (App. D, *infra*, 15a-20a) is not reported.

JURISDICTION

The judgment of the court of appeals (App. B, *infra*, 12a-13a) was entered on June 13, 1978. A timely petition for rehearing was denied on August

4, 1978 (App. C, *infra*, 14a). On August 31, 1978, Mr. Justice Blackmun extended the time for filing a petition for writ of certiorari to and including October 3, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 17(a)(1) of the Securities Act of 1933 prohibits fraudulent practices that injure brokers who serve as intermediaries in securities transactions but who are not themselves investors.

STATUTORY PROVISIONS INVOLVED

1. Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. 77q(a)(1), provides in part:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud * * *

2. Section 2(3) of the Securities Act of 1933, 15 U.S.C. 77b(3), provides in part:

> The term * * * "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

STATEMENT

1. Respondent, the principal of a registered broker-dealer firm and a sophisticated professional investor, engaged in a "short selling" scheme. Respondent selected stocks that, in his judgment, had peaked in price and were entering into a period of market decline. He then placed with brokers orders to sell shares of these stocks, although he did not own the shares he purported to sell (App. D, *infra*, 16a-18a). Gambling that the price of securities would decline substantially before he was required to deliver them,[1] respondent planned to make offsetting purchases through other brokers at lower prices and to take as profit the difference between the price at which he sold and the price at which he covered. Respondent falsely represented that he owned the shares he "sold;" he knew that the brokers who executed the sell orders would not have accepted them had they known that he did not own the securities (*id.* at 17a).[2]

---

[1] A broker may immediately execute an order to sell a customer's shares if it "is informed that the seller owns the security ordered to be sold and, as soon as is possible without undue inconvenience or expense, will deliver the security * * *." 17 C.F.R. 240.10a-1(d).

[2] By misrepresenting his ownership of the shares, respondent avoided the requirement that "short" sellers (that is, persons who sell a promise to produce shares in the future) make a substantial "margin" deposit with the brokers. See Regulation T, 12 C.F.R. 220.8(d). Brokers executing short sales are protected by such deposits against market fluctuations. Respondent's scheme, known colloquially as "free riding," is also described in *Naftalin & Co.* v. *Merrill Lynch,*

The market prices of the securities that respondent "sold" rose sharply prior to the settlement date. He was unable to make covering purchases, and he never delivered the securities (App. D, *infra*, 18a). The five brokers with whom respondent had placed the sell orders had in turn promised to deliver the shares to investors at the prices prevailing when respondent began his scheme. In order to keep their delivery promises, the brokers purchased the stock on the open market, a process known as "buying-in," at an aggregate loss to themselves of more than $1,000,000.[3]

2. After making the findings described above, the district court found petitioner guilty on eight counts of employing a scheme or artifice to defraud in the sale of securities, in violation of Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. 77q(a)(1). See App. D, *infra*, 15a-20a. Although the court of appeals thought the evidence sufficient to establish that respondent committed fraud (App. A, *infra*, 5a), it reversed his convictions. Reasoning that the purpose of Section 17(a)(1) is to "protect investors from fraudulent practices in the sale of securities" (App. A, *infra*, 6a-7a), the court concluded that "the government must prove some impact of the scheme on an investor" (*id.* at 8a). Because respondent's fraud injured brokers rather than investors, the court held, respondent's acts did not violate Section 17(a)(1).

Pierce, Fenner & Smith, Inc., 469 F.2d 1166, 1171-1172 (8th Cir. 1972), which found that he had engaged in "obvious and calculated wrongdoing."

[3] When a sell order is executed, and the seller fails to make delivery when due, the broker normally must "buy-in" substitute securities for the purchasers. See 17 C.F.R. 240.10a-2(a). See also 2 L. Loss, *Securities Regulation* 1229-1235 (2d ed. 1961). This "buy-in" procedure serves as a form of insurance for investors who purchase securities.

The court reversed the conviction on the sixth count of the indictment even though that count involved fraud on a broker who traded for his own account as an investor (App. D, *infra*, 17a). The court reasoned that "the indictment did not allege that [the defrauded broker] was a purchaser and * * * [respondent] could not be tried on charges that were not made" (App. A, *infra*, 10a).[4] Judge Ross dissented from the court's disposition of Count 6 of the indictment (*id.* at 11a).

REASONS FOR GRANTING THE PETITION

The decision of the court of appeals, which limits the coverage of Section 17(a)(1) to fraudulent practices injuring "investors," effectively removes federal criminal prohibitions against fraudulent securities

[4] We believe that the court's disposition of Count 6 is improper even assuming, for this purpose, that Section 17(a)(1) applies only to fraud on "investors." Ordinarily an indictment is sufficient if it sets out the language of the statute and the essential facts of the offense. *Hamling* v. *United States*, 418 U.S. 87, 117 (1974). Count 6 unquestionably is sufficient under the standard of *Hamling*. But because the court's treatment of Count 6 appears to involve only the (mis)application of settled principles to particular facts, we do not present it as a separate question for this Court's review. Of course, if the Court should accept our construction of Section 17(a)(1), it would follow that the convictions on all counts should be reinstated.

schemes in which the fraudulent statements are made to financial institutions serving as intermediaries in securities transactions. But the statute applies on its face to all fraudulent practices in "the offer or sale of any securities." This language prohibits fraud aimed at non-investor financial institutions. The Second Circuit has applied Section 17(a)(1) at face value, squarely rejecting the "investor" limitation adopted by the court below. See *United States* v. *Brown*, 555 F.2d 336, 338-339 (2d Cir. 1977).[5]

The decision in this case deprives the United States and the Securities and Exchange Commission of power to protect the principal participants in the nation's securities markets under Section 17(a)(1). Because protection of such participants from fraudulent schemes is essential to the integrity of the securities marketplace, this Court should review the court of appeals' decision and resolve the conflict among the circuits.

[5] Brown was prosecuted under Section 17(a)(1) for submitting counterfeit stock certificates to a transfer agent and obtaining genuine certificates in smaller denominations in exchange. Brown contended that his scheme was designed to defraud the transfer agent rather than any investor. The court of appeals, noting that Section 17(a)(1) "broadly condemns the employment of "any device, scheme, or artifice to defraud'" (*id.* at 339), stated that "there is no doubt that Congress in the broad language employed in [Section 17(a)(1)] was intent upon protecting the integrity of the marketplace in which securities are traded" (*ibid.*).

1. "'The starting point in every case involving construction of a statute is the language itself.'"[6] Section 17(a)(1) forbids "any person in the offer * * * of any securities * * * directly or indirectly * * * to employ any device, scheme, or artifice to defraud." Section 2(3) defines "offer" to include "every attempt or offer to dispose of * * * a security * * * for value."[7] Respondent placed "sell" orders for value with various brokers, and he employed a scheme to defraud in the course of placing those orders. The statute unambiguously proscribes respondent's conduct.

"Nothing on the face of the statute suggests a congressional intent to limit its coverage" (*United States* v. *Culbert*, No. 77-142 (March 28, 1978), slip op. 2) to fraud practiced on investors. Just as it was improper to restrict the scope of the Hobbs Act "by reference to an undefined category of conduct termed 'racketeering'" (*id.* at 9), so it was improper for the court of appeals to restrict the scope of Section 17(a)(1) to "the species of fraud" aimed at "investors" (App. A, *infra*, 5a). Here, as in *Culbert*, the broad

[6] *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 197 (1976); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977).

[7] "The definition of 'offer' is obviously much broader than the common law concept." 1 L. Loss, *Securities Regulation* 512 n.163 (2d ed. 1961). See also *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 467 n.8 (1969).

words of the statute "do not lend themselves to [such a] restrictive interpretation." [8]

We do not doubt that investor protection is an essential purpose of the Securities Act of 1933, just as the prevention of "racketeering" is an essential purpose of the Hobbs Act. But statutes commonly have more than one purpose and strike at more than one evil. So it is with the Securities Act of 1933. This Court summarized the general objectives of the statute in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 195 (1976) (emphasis added):

> The Securities Act of 1933 * * * was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, *to promote ethical standards of honesty and fair dealing.*

A principal purpose of the federal securities laws is "to insure the maintenance of fair and honest markets." 15 U.S.C. 78b.[9] Conduct that defrauds financial intermediaries such as brokers strikes at the heart of the securities markets.[10]

There was therefore no reason for the court of appeals to invoke the "rule of lenity" to narrow the literal application of Section 17(a)(1). As this Court observed in *United States* v. *Culbert*, *supra*, slip op. 8-9: "It is true that 'ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity'. * * * But here Congress has conveyed its purpose clearly, and we decline to manufacture ambiguity where none exists." See also *Scarborough* v. *United States*, 431 U.S. 563, 577 (1977). Because Section 17(a)(1) is literally applicable here, there is no ambiguity and no necessity to resort to rules of construction intended to resolve statutory uncertainties. See *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 354-355 (1943).

[8] This Court has often held that the securities laws should be interpreted broadly to effectuate their remedial purposes in government enforcement actions. See *Securities and Exchange Commission* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *Securities and Exchange Commission* v. *National Securities, Inc.*, 393 U.S. 453, 467 (1969); *Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943).

[9] Consistent with this purpose, it is "well settled" in the lower courts "that in a prosecution [under Section 17(a)(1)] the government is not required to prove that anyone was defrauded or that any investor sustained loss." *Farrell* v. *United States*, 321 F.2d 409, 419 (9th Cir. 1963) (collecting cases). See also *United States* v. *Brown*, *supra*.

[10] It has long been recognized that Rule 10b-5, 17 C.F.R. 240.10b-5, which was based on Section 17(a) (see *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 213 n.32), prohibits fraud practiced on "brokers." See *A. T. Brod & Co.* v. *Perlow*, 375 F.2d 393, 396-397 (2d Cir. 1967): "Neither § 10(b) nor Rule 10b-5 * * * speaks in terms of limiting the nature of the violation to one involving fraud on 'investors'; nor is there any justification for reading such an additional requirement into the act. * * * We believe that § 10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, wehther the artifices employed involve garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."

2. Even if it were correct to conclude that the 1933 Act protects investors only, it would not follow that frauds practiced on brokers are beyond the coverage of the statute. A broker usually acts as the agent of buyers and sellers. If the seller does not have the promised shares, they cannot be delivered to the buyer, and the buyer may suffer loss as a result. That loss is averted in cases like the present one by the requirement (see 17 C.F.R. 240.10a-2(a)) that the broker "buy in" real shares to deliver to the buyer of the phantom shares. This, like insurance, transfers the buyer's loss to a financial intermediary. Like insurance, it has a cost; in the long run it raises the brokerage fees paid by investors. And if, in some cases, brokers should be financially incapable of "buying in" to protect investors from loss, then investors would bear the loss directly.

It is not logical to conclude that the "species of fraud" practiced by respondent was beyond the scope of the securities laws simply because the investors were "insured" by the brokers' "buy in" of shares. As the Second Circuit pointed out in *United States* v. *Brown*, *supra*, 555 F.2d at 339, "[o]ne might as well argue that if Brown stole [some person's] fully insured automobile, he was never the victim of a larceny." The court continued (*ibid.*):

> The fact that the Uniform Commercial Code might ultimately shift the monetary loss from Smith and ultimate investors hardly serves to exculpate Brown and his group of fellow thieves, counterfeiters and forgers from criminal responsibility. This was not of course the garden variety of security fraud—its long planned execution * * * constituted a massive assault upon innocent investors and brokerage houses and their normal business procedures which we cannot construe the statute to countenance.

Fraud practiced on brokers results in greater losses to them, or perhaps in costly precautions to avoid loss. The costs of loss or precautions are ultimately borne by persons who use the services of brokers—the investing public. The decision below removes an important deterrent to fraud practiced against brokers, and, in the end, must serve to render brokerage services more costly or more cumbersome, to the detriment of all traders in securities.

3. At all events, the decision of the court of appeals seriously impairs the ability of the United States and the Securities and Exchange Commission to enforce the securities laws in cases involving fraud practiced on the largest participants in the national securities markets.[11] Brokers are integral parts of the securities exchange process, handling sales and

[11] The reasoning of the court below—that the "purpose" of the statute was to protect investors, and that mere agents are therefore beyond protection—would seem to apply equally under Section 10(b) of the 1934 Act, 15 U.S.C. 78j(b), as well as Section 17(a) of the 1933 Act. Indeed, the court placed principal reliance on authorities construing Section 10(b) (see App. A, *infra*, 7a). Thus, the decision of the court of appeals may mean, as a practical matter, that government enforcement actions under Section 10(b) will also be foreclosed in the Eighth Circuit in cases involving fraud on brokers and other securities professionals.

consummating purchases for customers throughout the nation.[12] The amount of money involved in such transactions is enormous. In 1975 brokers participated in securities transactions on national exchanges with a dollar volume of $166.9 billion. See *42d SEC Ann. Rep.* 192 (1976). Because Section 17(a) authorizes not only criminal prosecutions but also civil remedies, the effect of the decision here is to abolish one of the government's most effective weapons against the most serious forms of securities fraud practiced on members of the brokrage industry.[13]

The decision of the court of appeals also would bar government enforcement actions in cases where other financial institutions—including transfer agents, investment advisers, and commercial bank trust departments—have been defrauded. In each case it could be argued, with equal logic, that the defrauded financial intermediary was not an actual "investor" or "purchaser" of securities, and thus was beyond the scope of statutory protection.

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[12] "The securities markets of the United States are indispensable to the growth and health of this country's and the world's economy. In order to raise the enormous sums of investment capital that will be needed in the years ahead and to assure that capital is properly allocated among competing uses, these markets must continue to operate fairly and efficiently." H.R. Conf. Rep. No. 94-229, 94th Cong., 1st Sess. 91 (1975).

[13] There is no question in this case of enforcing a private implied right of action or of conferring "standing to sue." See *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977). This criminal prosecution is squarely predicated on Congressional grants of jurisdiction. See 15 U.S.C. 77q(a), 77x.

Brokers, transfer agents and investment advisers are subject to pervasive regulation under the federal securities laws. See 15 U.S.C. 78o *et seq.*, 15 U.S.C. 78q-1 *et seq.*, 15 U.S.C. 80b-1 *et seq.* Congress has not demonstrated any intent to impose the burdens of the securities laws on these financial institutions without conferring the protections of the securities laws, and those protections therefore should be available where, as here, they are literally applicable.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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OCTOBER 1978

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 77-1290

UNITED STATES OF AMERICA, APPELLEE

v.

NEIL T. NAFTALIN, APPELLANT

Appeal from the United States District Court for the District of Minnesota

Submitted: August 30, 1977
Filed: June 13, 1978

Before BRIGHT, ROSS and HENLEY, Circuit Judges

HENLEY, Circuit Judge.

Neil T. Naftalin, appellant here and defendant in the district court, was indicted on eight counts of employing a scheme to defraud in the offer or sale

of securities, in violation of § 17(a)(1) of the Securities Act, 15 U.S.C. § 77q(a)(1). Appellant was tried without a jury in the United States District Court for the District of Minnesota and found guilty on all eight counts. He was sentenced to five years imprisonment on each of the eight counts, to be served concurrently. This court has jurisdiction on appeal under 28 U.S.C. § 1291.

The alleged schemes to defraud consisted of appellant ordering five different brokers in eight separate transactions to sell stock listed on the New York Stock Exchange that appellant did not own at the time of the orders, either without disclosing that he did not own the stock or by affirmatively misrepresenting that he did own the stock. Counts I-V, VII and VIII of the indictment arose out of sell orders placed with various broker-dealers whereby the brokers became appellant's agents for the purpose of finding buyers for the stock and transferring the stock to the third party purchasers. Count VI, presently to be discussed separately, differs from the other counts in that the evidence adduced in support thereof shows that on August 28, 1969 H. S. Kipnis and Co., the brokerage house involved, purchased the securities mentioned in that count as a principal rather than acting as appellant's agent for the sale of the securities to third parties.

Appellant was the president and controlling shareholder of Naftalin and Co., Inc. (Company), a corporation registered as a securities dealer under federal and Minnesota securities laws. Prior to 1963,

the Company operated a public business as a broker-dealer. After 1963, and at the time of the transactions involved in this case, the Company had ceased doing business with the public and was operated essentially as a one-man business with appellant conducting all of its affairs.

From 1966 until the time of the transactions involved in this case, appellant had been trading for the Company's account in a number of stocks. The pattern of trading which appellant established during this period, and particularly in the summer of 1969, was to place large sell orders in the Company's name with various broker-dealers for listed stocks. Delivery of the securities for these transactions was often made weeks or months after the settlement dates set forth in the confirmation slips prepared and mailed to the Company by the brokers.[1]

Naftalin was, and is, a knowledgeable and sophisticated professional investor. It is possible that such a person can sell securities that he does not own without at the time disclosing he does not own them or representing falsely that he does own them. If before delivery of the securities is required the market price declines the seller can buy in the securities at a lower price and pocket the difference. Of course, if the market advances the seller suffers loss, and if

---

[1] A good description of Naftalin's over-all "short-selling" or "free-riding" mode of operation during the indictment period may be found in *Naftalin & Co.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166, 1170 (8th Cir. 1972). *See also United States* v. *Naftalin*, 534 F.2d 770 (8th Cir.), *cert. denied*, 429 U.S. 827 (1976).

he does not deliver the securities the broker through whom he sells suffers loss. To be sure, a seller lawfully may sell stock he does not own "short" if he discloses at time of sale that he is short and if he maintains appropriate brokerage accounts and otherwise trades according to prescribed procedures. However, the government charges in essence that undisclosed short sales misrepresented as sales of stock owned by the seller, *i.e.*, "long" with intent to deceive the broker and take a free ride on the broker's money or credit are made unlawful by § 17(a)(1) of the Securities Act, 15 U.S.C. § 77q(a)(1).[2]

Appellant never delivered any of the stock which he had agreed to deliver pursuant to the sell orders included in this case. With regard to Counts I-V, VII and VIII, when appellant failed to deliver the stock involved, the brokers ultimately purchased stock

[2] Securities Act of 1933, 15 U.S.C. § 77q(a):

> Sec. 17(a). It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> > (1) To employ any device, scheme, or artifice to defraud, or
> >
> > (2) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or
> >
> > (3) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

sufficient to cover the sales which they had arranged with third party purchasers. With perhaps one exception, the indictment transactions resulted in loss to the brokers. There is no evidence that any of the third party purchasers were deceived or defrauded in any way.

Appellant urges on appeal that the evidence adduced at trial was insufficient as a matter of law to support the district court's finding of fraud. While we are convinced there is no merit to that claim we pretermit further discussion of it and the factual details of the fraudulent acts at this juncture because we are not persuaded that the provision of § 77q(a)(1) under which appellant was put to trial is violated by the species of fraud practiced against the defrauded brokers who were not purchasers, and for that reason we reverse on all counts other than Count VI.[3]

With respect to the counts now under consideration, the government argues that the issue is whether the government alleged and proved a device, scheme or artifice to defraud in the offer or sale of a security. And the government insists that 15 U.S.C. § 77q(a)(1) does not require that the purchaser be defrauded,

[3] Other issues raised on appeal are (1) that the district court had no jurisdiction with regard to Counts I—V because of a lack of proof of use of the mails by appellant; (2) that sentencing on eight counts was improper since the proof showed only a single scheme to defraud; and (3) that appellant was exposed to double jeopardy due to prior disciplinary action which had been taken by the Securities and Exchange Commission in connection with the same stock transactions.

so long as someone is defrauded in the offer or sale of securities.

While we agree with the government's statement of the issue in this case, we do not agree with the government's analysis of the requirements of 15 U.S.C. § 77q(a)(1). It is clear that as between appellant and the brokers, there was no offer or sale of securities. Appellant made phone calls to the various brokers, during which he allegedly made a number of fraudulent statements, but he did not propose to sell any securities to the brokers alleged to have been defrauded. Appellant did request that the brokers find purchasers for appellant's stock and did authorize sales for his account. A stockbroker does not become the purchaser of stock when an owner requests that the broker sell certain of the owner's securities. The ordinary relationship of a stockbroker to his customer is that of principal and agent. *See Galiger* v. *Jones*, 129 U.S. 193 (1889); *McMann* v. *Securities and Exchange Commission*, 87 F.2d 377 (2d Cir. 1937). And the facts here clearly indicate that the stockbrokers were acting as agents of appellant, with the limited authority to find persons willing to purchase appellant's stock and subsequently to transfer the stock to the purchasers.

The third party purchasers to whom the brokers sold were not deceived or defrauded in any way. They received the securities from the brokers and paid the price they had contracted to pay.

The legislative purpose in enacting 15 U.S.C. § 77q(a)(1) was to protect investors from fraudulent

practices in the sale of securities. *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 195 (1976); *Securities and Exchange Commission* v. *International Chem. Dev. Corp.*, 469 F.2d 20, 26 (10th Cir. 1972); *Superintendent of Ins. of the State of New York* v. *Bankers Life & Cas. Co.*, 300 F.Supp. 1083, 1094 (S.D. N.Y.), *aff'd*, 430 F.2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U.S. 6 (1971); *Dolgow* v. *Anderson*, 43 F.R.D. 472, 482 (E.D. N.Y. 1968).

As Mr. Justice Powell noted in *Ernst, supra*, 425 U.S. at 194, federal regulation of transactions in securities emerged as part of the aftermath of the market crash in 1929. In the decade prior to 1933 the investing public suffered losses through investments in worthless securities estimated at twenty-five billion dollars. S.Rep. No. 47, 73rd Cong., 1st Sess., 2, to accompany S.875 (April 27, 1933). At the time there was national concern with public sales of worthless stock to persons who had no means of adequate protection and emphasis upon protecting the investing public from exploitation through sales of unsound, fraudulent and worthless securities. In a message to the Congress President Franklin D. Roosevelt on March 29, 1933 said in part:

> In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.
>
> Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their

> value will be maintained or that the properties which they represent will earn profit.
>
> There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.
>
> This proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.
>
> The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.

"Regulation of Security Issues," Message from the President of the United States, March 29, 1933. *House Document* No. 12, 73rd Congress.

It was against this backdrop that the Securities Act of 1933, including the section now codified as 15 U.S.C. § 77q(a)(1), was adopted. And it is against this backdrop that we are constrained to hold that the government must prove some impact of the scheme on an investor. *United States* v. *Ashdown*, 509 F.2d 793, 799 (5th Cir.), *cert. denied*, 423 U.S. 829 (1975), *quoting United States* v. *Schaefer*, 299 F.2d 625, 629-30 (7th Cir. 1962).

Our resolve is strengthened by reference to the general principle that statutes creating crimes are to be strictly construed in favor of the accused and before one may be punished it must appear that his

case is plainly within the statute. *United States* v. *Harris*, 544 F.2d 947, 949 (8th Cir. 1976); *United States* v. *Freeman*, 473 F.2d 7, 9 (8th Cir. 1973); *Jacobs* v. *United States*, 359 F.2d 960, 964 (8th Cir. 1966).

Moreover, the government has cited and our research has uncovered no case in which 15 U.S.C. § 77q(a)(1) has been used to prosecute a defendant for fraud in the sale of securities perpetrated upon an agent-broker, where no investor has been deceived or defrauded as a result of the fraud. We decline to expand the scope of 15 U.S.C. § 77q(a)(1) to encompass the facts of the present case.

Turning now to Count VI of the indictment, as indicated it may be observed that the evidence shows that on August 28, 1969 Naftalin called H. S. Kipnis & Co. (Kipnis) to sell 1,000 shares of Fairchild Camera (Fairchild). Kipnis, which both bought and sold Fairchild for its own account, executed the order by purchasing the shares.[4]

The evidence is somewhat conflicting as to representations, if any, made by Naftalin in connection with the sale and as to whether Naftalin was in fact "short." There are also facts including the fact of a substantial post sale payment on the Kipnis account by Naftalin in September, 1969 tending perhaps to show lack of fraudulent intent never to deliver stock or pay a debit balance.

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[4] We are not advised as to whether Naftalin knew immediately that Kipnis was the purchaser; however, in due course of business he learned the identity of the purchaser to whom he had sold.

On the other hand, there is strong evidence tending to support a finding of guilt.

Nevertheless, the conviction under Count VI must be reviewed precisely as the other counts were reviewed even though a sale to Kipnis was in evidence.

In passing upon pretrial motions the district court ruled that the entire indictment was not subject to dismissal on the ground that it did not charge Naftalin with having defrauded "purchasers," and rejected the government's argument that it could satisfy the purchaser requirement by proving that certain shares were sold to Kipnis.

In rejecting the government's argument, the trial court noted the indictment did not allege that Kipnis was a purchaser and observed that the defendant could not be tried on charges that were not made. Accordingly, the trial court concluded this portion of its reasoning by announcing that the government would be limited at trial to proof of violations of § 17 (a)(1). Under the statutory construction applied by the trial court this meant, of course, that proof of the fact of purchase by Kipnis was not to be considered essential at trial. Indeed, as the government concedes with commendable candor, fraud on the purchaser as purchaser was not charged.

Thus we have an anomolous situation in which we have held that the theory and facts upon which the case went to trial do not permit conviction, but in which we perhaps could sustain a conviction had the defendant been put to trial upon another basis.

In the circumstances, we must vacate the conviction on Count VI also.

The judgments of conviction are vacated and the indictment shall be dismissed.

ROSS, Circuit Judge, Concurring and Dissenting.

I concur in the disposition of all of the counts except Count VI. I would affirm the conviction as to Count VI.

A true copy.

Attest:

Clerk, U. S. Court of Appeals,
Eighth Circuit

APPENDIX B

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

SEPTEMBER TERM, 1977

No. 77-1290

[Filed June 13, 1978]

THE UNITED STATES, APPELLEE

vs.

NEIL T. NAFTALIN, APPELLANT

Appeal from the United States District Court for the District of Minnesota

JUDGMENT

THIS CAUSE came on to be heard on the designated record of the United States District Court for the District of Minnesota and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court, that the judgment and sentence of the said District Court as to Counts I-V, VII and VIII be and is hereby reversed.

And it is further ordered by this Court that this cause as to Count VI be and is hereby vacated and

the indictment shall be dismissed in accordance with the majority opinion of this Court.

June 13, 1978

[SEAL]

A true copy:

Attest:

/s/ Robert C. Tucker
Clerk, U. S. Court of Appeals,
8th Circuit

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

SEPTEMBER TERM, 1977

No. 77-1290

[Filed August 4, 1978]

THE UNITED STATES, APPELLEE

vs.

NEIL T. NAFTALIN, APPELLANT

Appeal from the United States District Court for the District of Minnesota

The Court having considered petition for rehearing en banc filed by counsel for appellee and, being fully advised in the premises, it is ordered that the petition for rehearing en banc be, and it is hereby, denied.

Considering the petition for rehearing en banc as a petition for rehearing, it is ordered that the petition for rehearing also be, and it is hereby, denied.

August 4, 1978

[SEAL]

A true copy:

Attest:

/s/ Robert C. Tucker
Clerk, U. S. Court of Appeals,
8th Circuit

APPENDIX D

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

Cr. No. 4-74-73

UNITED STATES OF AMERICA

v.

NEIL T. NAFTALIN

FINDINGS OF FACT, CONCLUSIONS OF LAW AND VERDICT

The above-entitled criminal matter came on for trial December 14, 1976, before the Court (a jury having been waived) on an eight-count indictment, each count charging Neil T. Naftalin with a violation of Title 15, United States Code, Section 77(q)(a).

Upon all of the evidence presented at trial, the Court finds as follows:

1. From on or about February 10, 1960, and continuing thereafter up to and including the present, Naftalin & Co., Inc., a corporation duly organized under and by virtue of the laws of the State of Minnesota, maintains its principal offices in Minneapolis, Minnesota. Since February 25, 1960 and continuous thereafter up to May 17, 1973, Naftalin & Co., Inc., was registered with the Securities and Exchange Commission pursuant to Section 15(b) of the Securi-

ties Exchange Act, Title 15, United States Code, Section 78*o*(b). Naftalin & Co., Inc., was also a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15A of the Securities Exchange Act, Title 15, United States Code, Section 78*o*-3, since 1960. From the time of its registration in 1960 through approximately the end of 1962, Naftalin & Co., Inc., conducted a general securities business in the over-the-counter market from its offices in Minneapolis, Minnesota. Since 1963 through December, 1969, except for a few isolated transactions, Naftalin & Co. did not conduct a public business, but rather traded for its own account through various broker/dealers.

2. At all times since its incorporation, Neil T. Naftalin, defendant herein, was President, principal executive officer, and majority shareholder of Naftalin & Co., Inc. Neil T. Naftalin was an experienced, knowledgeable and sophisticated investor and was familiar with the customs and terminology used in the trade.

3. From July 22, 1969 through August 28, 1969, Neil T. Naftalin knowingly employed a scheme and artifice to defraud Paine, Webber, Jackson and Curtis, Piper, Jaffray and Hopwood, Inc., Dain, Kalman and Quail, Inc., Merrill Lynch, Pierce, Fenner and Smith, Inc., and H. S. Kipnis & Co., Inc.

As a part of said scheme and artifice to defraud the above firms, Neil T. Naftalin placed sell orders with the above firms for the cash account of Naftalin

& Co., Inc., for the stocks of American Research and Development, Avon Products, Inc., Burroughs Corporation, Control Data Corporation, and Fairchild Camera and Instrument. In each instance defendant Naftalin represented Naftalin & Co. to be "long" in the stock, either by direct statement to that effect or by using words and phrases in placing the sell order which would be understood in the trade as a representation that Naftalin & Co. was "long" in the stock. In each instance Naftalin & Co. was "short" the stock involved. Neil T. Naftalin knew that each of the firms would not have accepted the sell orders, except that giving rise to Count 6 of the indictment, had they known that Naftalin & Co. was "short" the stock. They either would not have taken the sell order at all or would have required a margin deposit. As to Count 6, the short sale of 1000 shares of Fairchild Camera through H. S. Kipnis & Co., Kipnis would not have required margin because it dealt in that stock as a principal, but, as Neil T. Naftalin knew, it would have refused to complete the transaction had it known that Naftalin & Co. was not in a position to deliver the stock as represented by Neil T. Naftalin.

As a part of the scheme and artifice to defraud the above firms in the sell orders placed with respect to the above stocks, Neil T. Naftalin lulled the above firms into believing Naftalin & Co. was long in the stocks by responding to the firms' demands for delivery of the stock with assertions that Naftalin & Co. was "long" and the stock was on its way to Naftalin

& Co. from other brokers, banks, or transfer agents. None of the securities sold by Naftalin & Co. in the transactions alleged in the indictment were delivered by Naftalin & Co. Each broker had to buy the securities in (and in all but one case, said buy ins were at a loss).

4. With respect to Count One, Neil T. Naftalin employed the scheme to defraud, described in paragraph 3 herein, by placing a sell order for 500 shares of American Research and Development with Paine, Webber, Jackson and Curtis on July 22, 1969, and caused said firm to send and deliver by United States mail an envelope addressed to Naftalin & Co. containing a written confirmation of that sale.

5. With respect to Count 2, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 hereby placing a sell order for 1000 shares of Burroughs Corporation with Paine, Webber, Jackson and Curtis on August 5, 1969, and caused said firm to send and deliver by United States mail an envelope addressed to Naftalin & Co. containing a written confirmation of that sale.

6. With respect to Count 3, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 herein by placing a sell order for 1000 shares of Burroughs Corporation with Piper, Jaffray & Hopwood, Inc., on August 7, 1969, and caused said firm to send and deliver by United States mail an envelope addressed to Naftalin & Co. containing a written confirmation of that sale.

7. With respect to Count 4, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 herein by placing a sell order for 1000 shares of Control Data Corporation with Dain, Kalman and Quail, Inc., on August 8, 1969, and caused said firm to send and deliver by United States mail an envelope addressed to Naftalin & Co. containing a written confirmation of that sale.

8. With respect to Count 5, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 herein by placing a sell order for 500 shares of American Research and Development with Merrill Lynch, Pierce, Fenner and Smith, Inc., on August 20, 1969, and caused said firm to send and deliver by United States mail an envelope addressed to Naftalin & Co. containing a written confirmation of that sale.

9. With respect to Count 6, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 herein by placing a sell order for 1000 shares of Fairchild Camera and Instrument Corporation with H. S. Kipnis & Co. on August 28, 1976, and in placing such sell order the defendant used a communication in interstate commerce, that is, a telephone call from Minnesota to Illinois.

10. With respect to Count 7, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 herein by placing a sell order for 500 shares of American Research and Development with H. S. Kipnis & Co. on August 4, 1969, and in placing such sell order the defendant used a communication in interstate commerce, that is, a telephone call from Minnesota to Illinois.

11. With respect to Count 8, Neil T. Naftalin employed the scheme to defraud described in paragraph 3 herein by placing a sell order for 1000 shares of Avon Products, Inc., with H. S. Kipnis & Co. on August 1, 1969, and in placing such sell order the defendant used a communication in interstate commerce, that is, a telephone call from Minnesota to Illinois.

From the above facts, the Court finds that as to each count the government has proven beyond a reasonable doubt that Neil T. Naftalin employed a scheme or artifice to defraud in the sale of securities and has used the mails or a communication in interstate commerce in said scheme.

As to each count of the indictment, the Court finds that the defendant acted as charged in the count wilfully and knowingly.

The Court finds the defendant guilty of each count in the indictment.

/s/ Earl R. Larson
United States District Judge

Dated: February 1, 1977.

☆ U. S. GOVERNMENT PRINTING OFFICE; 1978 274154 127

Supreme Court, U. S.
FILED
JAN 25 1979
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-561

UNITED STATES OF AMERICA,
Petitioner

—v.—

NEIL T. NAFTALIN

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI FILED OCTOBER 2, 1978
CERTIORARI GRANTED DECEMBER 11, 1978

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-561

UNITED STATES OF AMERICA, *Petitioner*

—v.—

NEIL T. NAFTALIN

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

INDEX

CRIMINAL DOCKET
UNITED STATES DISTRICT COURT

4-11-74 1) Filed Indictment

Ent'd. Order (Devitt, J.) for Issuance of Warrant of Arrest, Bond set at $5,000 (10%)

Issued W/A and delvd. to U.S. Marshal.

4-12-74 2) Filed Warrant of Arrest with marshal's ret. of serv. 4-12-74

3) Filed $5,000 Bond (10% Deposit or $500.00)

4-29-74 4) Ent'd. arraignment Summary and Proceedings before Magistrate Cudd.

5) Ent'd. arraignment (Magistrate Cudd) on Ct. 1 thru 8, and plea of Not Guilty entered. Bond Cont in present amount, will sign order authorizing travel in 48 states. Counsel shall have 21 days in which to file motions.

5-3-74 6) Filed Order (Cudd, Magistrate) bond of deft. shall not restrict him from traveling anywhere in the United States (continental).

Mailed copy of aforesaid Order to counsel.

5-17-73 7) Filed Defts. Notice of Motion and Motion returnable May 29, 1974 at 9:30 A.M. for Discovery and Inspection with aff. of serv. by mail 5-17-74.

6-4-74 8) Filed Order (Cudd, J.) Deft. shall have thirty days from date of this Order to file his motion to dismiss the Indictment and to file any motions to suppress evidence.

Mailed copies to counsel.

6-11-74 9) Filed Stipulation and Order (Larson, J.) between attorneys for pltf. and defendant, that time which Deft. has to serve and file written exceptions with this Court to Order of the U.S. Magistrate, the Honorable J. Earl Cudd, in the above captioned matter dated June 4, 1974, may be, and it is hereby extended to and including June 14, 1974.

Mailed Stipulation and Order copies to counsel.

6-14-74 10) Filed Written Exception to Magistrate's Order of June 4, 1974, on Motion for Discovery and Inspection of Deft.

7-23-74 11) Filed Order (Larson, J. 7-19-74) that the time within which the deft. may file a motion to dismiss the indictment and/or to suppress evidence may be and the same hereby is, extended to a time 10 days after this Court rules upon the deft's written exceptions to Magistrate's order on Discovery, or such other time as the Court may determine in its order on the written exceptions.

12) Mailed notice to counsel of record.

7-29-74 13) Filed Order (Larson, J.) that deft's exceptions to Magistrate's order be denied. Motions to dismiss Indictment if any will be filed within 10 days. If Oral argument is requested by either party, the hearing will be held by Wednesday, August 14, 1974 at 8:45 A.M.

Mailed copies to counsel and delivered copy to U.S. Marshal.

8-14-74 4) Filed motion of defendant to dismiss indictment and for other relief, with aff. of service personally on 8-14-74.

15) Filed affidavit of Neal T. Naftalin, with aff. of service personally on 8-14-74.

8-30-74 16) Entd. defts. mo. for dismissal (Larson, J-Stafford, R.) argued, submitted and taken under advisement.

9-9-74 17) Filed Affidavit of John I. Mayer, 7251 W. Randolph St. Forest Park, Illinois, 60130 in above entitled matter.

18) Filed Affidavit of Barry D. Goldman, 6033 North Sheridan Road, Chicago, Ill. 60660 in above entitled matter.

19) Filed Affidavit of Martin A. King, 8525 Springfield Avenue, Skokie, Illinois 60076 in above entitled matter.

20) Filed Affidavit of Dennis J. Waldeck, 1949 Whitingham Lane, Hoffman Estates, Illinois 60172 in the above entitled matter.

9-9-74 21) Filed Affidavit of William D. Goldsberry, 126 S. Harvard, Arlington Heights, Illinois 60005 in the above entitled matter.

22) Filed Affidavit of Judith Joyce Shanahan, 300 Richmond Road, Kenilworth, Illinois, in the above entitled matter.

23) Filed Affidavit of Thomas E. Lynch, 1833 Greenleaf Avenue, Chicago, Illinois, in the above entitled matter.

24) Filed Affidavit of Jeffrey I. Bernstein, 1150 N. Lake Shore Drive, Chicago, Illinois, in the above entitled matter.

25) Filed affidavit of Joseph L. Grant, 3411 Camelot Drive N.E., Marietta, Georgia, in the above entitled matter.

26) Filed Affidavit of John Turner, 2623 Ivy Dale Drive, S.W., Atlanta, Georgia, 30318 in the above entitled matter.

9-12-74 27) Filed Transcript of Proceedings (Motion) August 30, 1974 (Stafford, R.)

9-16-74 Filed reporters Notes (Motions) 8-30-74 (Stafford, R.) in R Box 74-9.

1-24-75 28) Filed Order (Larson-J.) that the govt. produce for in camera inspection within 30 days the documents requested in paragraph 14, subdivision (a), (b), and (c) of defts motion for discovery and inspection; that judgment is reserved on defts motion to dismiss the indictment because of delay in instituting prosecution; and that except the aforesaid reservation on defts motion to dismiss because of delay in instituting prosecution, the defts motion to dismiss the indictment in its entirety, to dismiss certain counts of the indictment and to strike certain allegations as surplusage are denied.

Mailed copy of aforesaid order to counsel.

1-28-75 29) Filed Memorandum (Larson, J.) explaining his Order dated 1-24-75 which stated "MEMORANDUM TO FOLLOW".

Mailed copy of aforesaid Memorandum to Counsel.

4-24-75 30) Entd. record of hearing (Larson, J-Stafford, R.) Defts. Motion to dismiss indictment because of delay in instituting prosecution. Hearing cont. to 4-25-74 9:15.

4-25-75 31) Entd. record of hearing cont. (Larson, J-Stafford, R.) Defts. motion to dismiss because of delay in instituting prosecution. Submitted and taken under advisement, subject to filing of brief.

5-5-75 Filed reporters notes in Box R6,1975, (Motion) as of April 24, and 25, 1974.

5-5-75 32) Filed Transcript of Proceedings (Motion to Dismiss Indictment because of delay instituting prosecution) as of 4-24-75 (Stafford, R.).

8-8-75 33) Filed Order (Larson, J.) that deft. Naftalin motion to dismiss the Indictment granted.

34) Mailed copies of Order to Counsel.

9-4-75 35) Filed Notice of Appeal of the United States of America from the Order of the United States District Court of Minnesota, 4th Division, dated August 8, 1975, dismissing the indictment in the above entitled matter.

Delivered c/c of Notice of Appeal to U.S. Marshal.

Delivered c/c of Notice of Appeal to Iris Stafford, 542 U.S. Courthouse, Minneapolis, Minnesota, official court reporter to Judge Earl R. Larson.

Mailed c/c of Notice of Appeal to Joe Walter, 3848 IDS Center, Mpls. Minn. counsel for deft.

Mailed c/c of Notice of Appeal, two certified copies of docket entries to date and transmittal form to Mr. Robert C. Tucker, Clerk, United States Court of Appeals for the 8th Circuit, U.S. Courthouse and Customs House, St. Louis, Missouri, 63101.

9-12-75 36) Filed Designation of Record and Statement of Issues of the United States Government, Appellant, in the above entitled matter.

9-24-75 37) Filed Letter from counsel for Defendant Naftalin concurring with Designation of the Government.

Mailed original and two copies of Items Number 1, 6, 7, 8, 9, 11, 13, 14, 28, 29, 33, 36 and 37, as designated by the Appellant together with Item 27, Transcript of Proceedings (Motion to Dismiss Indictment) as of 8-30-74 and Item 32 (Motion to Dismiss Indictment because of delay in instituting prosecution) 4-24-75 designated by Appellant, with three certified copies of docket entries to date; Included also are Deft. Exhibits A thru O and under separate cover Government Exhibit No. 1 shipped in two separate cartons marked Carton 1 and Carton 2, to Mr. Robert C. Tucker, Clerk, United States Court of Appeals for the Eighth Circuit, U.S. Courthouse and Customs House, St. Louis, Missouri 63101.

4-28-76 38) COPY OF ORDER of U.S. Court of Appeals for the Eighth Circuit dated April 26, 1976, staying issuance of the mandate for a period of thirty days.

39) NOTICE TO COUNSEL.

10-20-76 40) OPINION FROM U.S. COURT OF APPEALS FOR THE EIGHTH CIRCUIT reversing the District Court's order of dismissal and remanding with instructions to reinstate the indictment.

41) JUDGMENT FROM U.S. COURT OF APPEALS FOR THE EIGHTH CIRCUIT reversing the District Court's order of dismissal and remanding with instructions to reinstate the indictment.

42) NOTICE TO COUNSEL.

10-28-76 43) MINUTES OF PROCEEDINGS (Larson J-Stafford, R.) bond. cont. Waiver of Jury trial signed.

44) STIPULATION AND ORDER WAIVING Jury Trial (Larson, J.)

12-9-76 ELECTRONIC RECORDING Box 35 Env. 320 10-28-76 (Waiver of Jury Trial) (Stafford, R.)

12-9-76 45) MOTION of deft. to dismiss and for finding not Guilty.

12-14-76 46) MINUTES OF Court Trial: (Larson, J-Stafford, R.)

12-16-76 47) MINUTES OF Court Trial: (Larson, J-Stafford, R.)

12-17-76 48) MINUTES OF Court Trial: (Larson, J-Stafford, R.)

12-20-76 49) MINUTES—OF COURT TRIAL: Larson, J-Stafford, R.) Court Trial. Mr. Walters atty. for deft. renews the motion for Jdgt. of Acquittal and moves the Court to find the facts specially under Rule 23(c) and for arrest of Judgment under Rule 34. Ruling is reserved. Trial recessed to 12-21-76 9:30 A.M.

12-21-76 50) MINUTES OF COURT TRIAL: (Larson, J-Stafford, R.) deft. motion to consolidate the 8 counts in the Indictment into 1 count is denied. Mr. Anderson and Mr. Walters make closing arguments to the Court. Decision is reserved including ruling on deft. motion for judgment of acquittal and for dismissal account double jeopardy.

2-1-77 51) MINUTES OF PROCEEDINGS: (Larson, J-Stafford, R.) Determination of Guilt or innocence. Copy of Findings of Fact, conclusions of law and Verdict is handed to respective counsel. Defendant's motion for acquittal, made at the trial is denied. Deft. is referred to the Probation Office for pre-sentence investigation.

52) FINDINGS OF FACT. Conclusions of Law and Verdict of the Court finding the defendant guilty of each count in the Indictment.

53) NOTICE TO COUNSEL.

2-8-77 54) NOTICE AND MOTION to arrest Judgment, for a new trial, finding that defendant is Not Guilty and dismissal of Indictment returnable before Judge Earl R. Larson, Judge of the United States District Court for the District of Minnesota at a time to be set by the Court.

2-24-77 ELECTRONIC RECORDING NOTES in Box 36 Env. 338 Determination of guilt or innocence 2-1-77 Stafford, R.)

3-11-77 55) AFFIDAVIT of Neil T. Naftalin in support of defendant's motion to arrest Judgment, for a new trial, for a finding that defendant is not guilty and dismissal of the indictment.

3-18-77 56) MINUTES OF PROCEEDINGS: (Larson, J-. Stafford, R.) deft. motion to arrest judgment; for a new trial; for finding of not guilty and dismissal of indictment. Motion is denied. Deft. motion for Judgment of Acquittal made at the close of court trial, is denied.

SENTENCE IS IMPOSED: Imprisonment for five years on each of eight counts of Indictment, said sentences to run concurrently. Bond is ordered continued pending determination whether appeal will be filed.

Issued Jdgt. and Commitment and dlvd. two c/c to U.S. Marshal.

3-23-77 57) C/C OF JUDGMENT AND COMMITMENT—Served 3-21-77.

3-25-77 58) NOTICE OF APPEAL. Receipt 64306

Dlvd. c/c to U.S. Attorney

Dlvd. c/c to U.S. Marshal

Dlvd. c/c to Iris Stafford, Official Court Reporter to Judge Earl R. Larson, 446 U.S. Courthouse, Minneapolis, Minnesota 55401 (612) 335-0119

Mailed c/c Notice of Appeal, two c/c of Docket entries to date together with transmittal form to Mr. Robert C. Tucker, Clerk, U.S. Court of Appeals for the 8th Circuit, U.S. Courthouse and Customs House, St. Louis, Missouri 63101.

3-29-77 ELECTRONIC RECORDING AND NOTES in Box 36 Env. 349 (3-18-77 Motions and Sentencing) Stafford, R.

59) AMENDED NOTICE OF APPEAL.

Dlvd. c/c to U.S. Attorney

Dlvd. c/c to U.S. Marshal

Dlvd. c/c to Iris Stafford, Official Court Reporter to Judge Earl R. Larson, 446 U.S. Courthouse, Minneapolis, Minnesota 55401 (612) 335-0119

Mailed c/c Amended Notice of Appeal, two c/c of Page 6 of the Docket entries to Mr. Robert C. Tucker, Clerk, U.S. Court of Appeals for the 8th Circuit, U.S. Courthouse and Customs House, St. Louis, Missouri 63101.

3-31-77 60) MOTION of deft. for an ORDER to clerk of Federal District Court to grant temporary custody of all trial exhibits to defendant's attorneys.

61) ORDER (Larson, J.) to Clerk of Federal District Court granting temporary custody of all trial exhibits to defendant's attorneys.

62) NOTICE TO COUNSEL.

4-4-77 63) APPELLANT'S DESIGNATION OF RECORD AND STATEMENT OF ISSUES.

4-14-77 64) ORDER of the United States Court of Appeals for the Eighth Circuit that appellant in this case is granted permission to proceed in forma pauperis to the extent that the United States will pay for preparation of the transcript of testimony. The official court reporter for the District of Minnesota is directed to prepare, at the expense of the United States, an original and one copy of the transcript. The original is to be delivered to counsel for appellant and the copy filed with the clerk of the district court for transmittal to the clerk of this court. The court enters this order after finding that preparation for transcript at the expense of the United States is required for disposition of the appeal.

65) NOTICE TO COUNSEL. Dlvd. copy of order to Iris Stafford, Official Court Reporter to Judge Earl R. Larson.

4-15-77 66) APPELLEE'S DESIGNATION OF RECORD. Mailed Designated Record on Appeal and two copies to Mr. Robert C. Tucker, Clerk, United States Court of Appeals for the Eighth Circuit, U.S. Courthouse, St. Louis, Missouri 63101. (All trial exhibits and transcripts will be sent upon completion of the transcripts).

4-27-77 67) ORDER from the United States Court of Appeals for the Eighth Circuit, that the appellant may proceed in forma pauperis and proceed under local rule 11; however, if the appellee, United States, desires a court reporter to transcribe opening and closing statements, the appellee should order and pay for them directly.

68) NOTICE TO COUNSEL. Dlvd. copy to Iris Stafford, official court reporter to Judge Larson.

5-2-77 69) TRANSCRIPT OF PROCEEDINGS (Motions and Sentencing) 3-18-77 (Stafford, R.)

70) TRANSCRIPT OF PROCEEDINGS (Index to Trial Proceedings 12-14 thru 12-21, 1976) Stafford, R.)

71) TRANSCRIPT OF PROCEEDINGS (Volume I Trial) Dec. 14, 1976 Pages 1 thru 197.

72) TRANSCRIPT OF PROCEEDINGS (Volume II Trial) Dec. 16, 1976, Pages 198 thru 352 and Dec. 17, 1976, Pages 353 thru 438.

73) TRANSCRIPT OF PROCEEDINGS (Volume III Trial) Dec. 20, 1976, Pages 439 thru 582 and December 21, 1976 Pages 583 thru 621.

74) CJA 21 for Transcripts, Iris Stafford, Court Reporter. Mailed copies 1 and 4 to Administrative Office, filed copy 5 in Clerk's file, Copy 3 to Court Reporter and copy 2 on left side of clerk's file.

Mailed Items 69 thru 73 together with Govt. and Deft. Exhibits this date to Mr. Robert C. Tucker, Clerk, U.S. Court of Appeals for the 8th Circuit, U.S. Courthouse and Customs House, St. Louis, Missouri 63101.

5-16-77 REPORTER's NOTES Re: Court trial on 12-/14-16-17-20-21/76 in Box R-77-4 (Stafford, R)

8-5-77 75) c/c of Order of the United States Court of Appeals for the 8th Circuit remanding this case to the United States District Court for the District of Minnesota for the purpose of acting on appellant's motion for admission to bail pending appeal and, if the said petition is granted, for the purpose of setting the terms of release on bail pending appeal.

76) NOTICE TO COUNSEL.

8-12-77 77) ORDER (Larson, J.) That the motion for release on bail pending appeal and decision by the Court of Appeals is granted. (2) That the bond in its present form and amount be continued.

8-12-77 78) NOTICE TO COUNSEL. c/c to Robert Tucker, Clerk U.S. Court of Appeals for the 8th Circuit, c/c to deft. FCI, Sandstone, and to Classification and Parole, Sandstone, Minnesota and to U.S. Marshal.

8-17-78 79) MANDATE of the United States Court of Appeals for the 8th Circuit vacating the conviction on Ct. VI and the Judgment of conviction and also the Indictment shall be dismissed.

80) JUDGMENT of the United States Court of Appeals for the 8th Circuit on consideration whereof, it is now here ordered and adjudged by this court, that the Judgment and sentence of the United States District Court for the District of Minnesota, as to Counts I-V, VII and VIII be and is hereby reversed. And it is further ordered by this Court that this cause as to Count VI be and is hereby vacated and the Indictment shall be dismissed in accordance with the majority opinion of this Court.

81) NOTICE TO COUNSEL. c/c to Deft.

GENERAL DOCKET

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

DATE

1977

Mar. 30 Cert. copies Notice of Appeal, Docket Entries of D.Ct.

Mar. 30 Request for docketing fee.

Apr. 1 Amended notice of appeal rec'd from District Court

Apr 7 Appearance for appellant.

Apr 7 Mo applnt for lv to proceed in forma pauperis for transcript at gov. expense.

Apr 7 Affidavit in support of motion.

Apr 12 Order: U.S. will pay for transcript of testimony; court reporter is directed to prepare original and one copy, etc.

Apr 18 RECEIVED ORIGINAL AND TWO COPIES DESIGNATED RECORD

Apr 18 Motion appellant to modify order of April 12

Apr 25 Order: Appellant may proceed in forma pauperis and under local rule 11; however, if the U.S. desires a court reporter to transcribe opening and closing statements; the appellee should order and pay for them directly

May 2 28 day ltr: Aplnt BR due 5/30/77 (TR fld in DtCt 5/2/77)

May 5 RECEIVED 1 VOLUME MOTIONS AND SENTENCING; 1 INDEX TO TRIAL PROCEEDINGS; 3 VOLUMES TRANSCRIPT; 2 BROWN ENVELOPES OF EXHIBITS.

May 31 *Brf aplnt* w/ser O+4

June 20 Request by counsel for appellant for o/a at earliest opportunity.

DATE

1977

June 24 Mo appellee for ext of time to file brief.

June 24 Order: Appellee may have thru July 1 to serve and file answer brief

Jul 5 *Brf aplee* O+5

Jul 5 Ser w/brf aplee

Jul 11 *Rep brf applnt* w/ser O+4

July 22 Mo applnt for bail.

Aug 2 Transferred to August session

Aug. 3 Order: Court remands this case to Dist. Ct. for purpose of acting on appellant's motion for admission to bail pending appeal, & if said petition is granted, for the purpose of setting the terms of release on bail pending appeal.

Aug 16 Certified copy order of District Court granting mo for release on bail pending appeal and continuing bond in its present form and amount.

Aug. 30 Appearance for appellee

Aug. 30 Arg. & sub. to Judges Bright, Ross, Henley. Joe A. Walters for appellant. Thorwald H. Anderson, Jr., AUSA for appellee. Concl. by Walters. Recorded.

1978

June 13 Opinion by Judge Henley. Concurring & dissenting opinion by Judge Ross (Published)

June 13 JUDGMENT: Judgment & sentence of Dist.Ct. as to Counts I-V, VII, and VIII is reversed; as to Count VI is vacated and dismissed in accordance with majority opinion.

June 26 Mo appellee for ext of time to file pet for reh.

June 26 Certificate of service.

July 3 ORDER: Appellee may have to and including 7/27/78 to serve and file petition for rehearing.

DATE

1978

July 27 Petition of appellee for rehearing en banc and rehearing T

July 27 Certificate of service of appellee's petition for rehearing.

Aug. 4 ORDER: Petition of appellee for rehearing en banc and rehearing is denied.

Aug 14 Mandate issued.

Aug 18 Receipt for mandate.

Sept 5 Letter from Clerk of Supreme Court stating extention of time to file petition for writ of certiorari has been granted to 10/3/78 by Mr. Justice Blackmun in Case No. A-214.

Oct. 24 Notice of filing of petition for writ of certiorari to Supreme Ct. in Case No. 78-561 (as of 10/2/78)

Dec 15 Order of Supreme Court GRANTING certiorari in Case #78-561.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

UNITED STATES OF AMERICA

v.

NEIL T. NAFTALIN

INDICTMENT

(15 U.S.C. § 77(q) (a))

The United States Grand Jury charges that:

COUNT I

1. From on or about July, 1969, and continuing thereafter to on or about October, 1969, in the District of Minnesota, and within the jurisdiction of this court and elsewhere,

NEIL T. NAFTALIN

defendant herein, wilfully and knowingly did employ a scheme and artifice to defraud broker/dealers and said defendant did employ manipulative and deceptive devices and contrivances and did engage in fraudulent transactions, practices, and a fraudulent course of business which scheme and artifice to defraud and fraudulent transactions, practices and course of business are set forth more fully below:

2. From on or about February 10, 1960, and continuing thereafter up to and including the present, Naftalin & Co., Inc., a corporation duly organized under and by virtue of the Laws of the State of Minnesota, maintains its principal offices in Minneapolis, Minnesota. Since February 25, 1960 and continuous thereafter up to May 17, 1973, Naftalin & Co., Inc., was registered with the Securities & Exchange Commission pursuant to Section 15(b) of the Securities Exchange Act, 15 U.S.C. Sec.

78*o*(b). Naftalin & Co., Inc. was also a member of the National Association of Securities Dealers, Inc., a national securities association registered pursuant to Section 15A of the Securities Exchange Act, 15 U.S.C. Sec. 78*o*-3, since 1960. From the time of its registration in 1960 through approximately the end of 1962, Naftalin & Co., Inc. conducted a general securities business in the over-the-counter market from its offices in Minneapolis, Minnesota. Since 1963 through December, 1969, except for a few isolated transactions, Naftalin & Co. did not conduct a public business, but rather traded for its own account through various broker/dealers.

3. At all times mentioned in this indictment, Neil T. Naftalin, defendant herein, was President, principal executive officer, and majority shareholder of Naftalin & Co., Inc.

4. As part of said scheme and artifice to defraud and fraudulent course of business and for the purposes of deceiving and defrauding the broker/dealers and to carry out the scheme to defraud, defendant Neil T. Naftalin did directly and indirectly in the offer and sale of securities, to wit, the stocks of: American Research and Development, Avon Products, Inc., Burroughs Corporation, Control Data Corporation, Fairchild Camera and Instrument, knowingly and wilfully make false and misleading statements of material facts, which statements included, but were not limited to the following:

A. That Naftalin & Co., Inc. owned the aforementioned securities.

B. That Naftalin & Co., Inc. was long the securities being sold.

C. That the sale of the aforementioned securities was not a short sale.

D. That delivery of the aforementioned securities would be delayed because Naftalin & Co., Inc., had purchased them in the third market and the securities were carrying due bills.

5. It was further part of said scheme and artifice to defraud and fraudulent course of business and for the

purposes of deceiving and defrauding the broker/dealers and to carry out the scheme to defraud, defendant, Neil T. Naftalin, did directly and indirectly in the offer and sale of the aforementioned securities by Naftalin & Co., Inc. knowingly and wilfully omit to state and did conceal from the broker/dealers material facts which were necessary in order to make the statements made in the light of the circumstances under which they were made, not misleading, including, but not limited, to the following:

A. That the sales were short sales.

B. That Naftalin & Co., Inc. could not meet the margin requirements for the short sales.

C. That Naftalin & Co., Inc. had made other short sales.

D. That broker/dealers to or through whom Naftalin & Co., Inc. had made short sales were requesting Naftalin & Co., Inc. to make delivery.

E. That Naftalin & Co., Inc. was financially unable to purchase or otherwise acquire stock necessary to cover the short sales.

6. As further part of said scheme and artifice to defraud and fraudulent course of business and for the purpose of deceiving and defrauding the broker/dealers and to carry out the scheme to defraud, defendant Neil T. Naftalin did directly and indirectly in the offer and sale of the aforementioned securities knowingly and wilfully subsequent to the settlement dates, make false and misleading statements of material facts, including, but not limited to the following:

A. That the securities sold had been purchased in the third market and had not yet been received by said Naftalin & Co., Inc.

B. That the securities sold had been split and delivery was slow.

C. That the stock "was coming" or "was en route."

D. That delivery of the securities had already been attempted.

E. That the trades were being processed at the bank that handled Naftalin & Co., Inc.'s clearances.

F. That there were long sales of the securities which Naftalin & Co., Inc. was receiving from other brokers.

G. That Naftalin & Co., Inc. was in the process of obtaining proper certificate denominations for delivery and that the broker/dealer should not "buy in" Naftalin & Co., Inc.

H. That the securities sold as aforesaid by Naftalin & Co., Inc. were due Naftalin & Co., Inc. from other brokers and had not yet been received.

I. That some of the said securities would be delivered in a week or a week and a half.

J. That Naftalin & Co., Inc. was having difficulty in obtaining delivery of some of said securities from its sellers.

7. On or about July 22, 1969, and continuing thereafter until on or about October 2, 1969, the said defendant, Neil T. Naftalin, did by the use of the mails in the offer and sale of securities to Paine, Webber, Jackson and Curtis, unlawfully, wilfully and knowingly, in the manner and means more fully described above, directly and indirectly employ said device, scheme and artifice to defraud, and did engage in transactions, practices and a course of business which would and did operate as a fraud and deceit upon Paine, Webber, Jackson and Curtis, such use of the mails being as follows:

The defendant, Neil T. Naftalin, on or about July 22, 1969, wilfully and knowingly, directly and indirectly caused Paine, Webber, Jackson & Curtis, to send and deliver by the United States mail an envelope addressed to Naftalin & Co., Inc., at Minneapolis, Minnesota, which envelope contained a confirmation for the sale of 500 shares of American Research and Development, all in violation of Title 15, Section 77(q)(a) of the United States Code.

COUNTS TWO THROUGH FIVE

The United States Grand Jury further charges that:

1. Paragraphs 1 through 6 of Count One are realleged herein.
2. On or about the respective dates set forth below in each of Counts Two through Five, in the District of Minnesota,

NEIL T. NAFTALIN

defendant herein, did, by use of the mails in the offer and sale of securities to each of the respective broker/dealers set forth hereinafter in Counts Two through Five in the manner and means more fully described above, willfully and knowingly, directly and indirectly, employ said device, scheme and artifice to defraud, and did engage in transactions, practices, and a course of business which would and did operate as a fraud and deceit upon the respective broker/dealers set forth hereinafter, and said defendant wilfully and knowingly, directly and indirectly caused to be sent and delivered by the United States mail such matters as hereinafter specified:

Count	*Broker/Dealer*	*Date*	*Security Involved*	*Matter Sent & From Whom*
Two	Paine, Webber, Jackson & Curtis	8-5-69	1,000 shares of Burroughs Corporation	An envelope sent with confirmation of 1,000 shares sold, sent by Paine, Webber, Jackson & Curtis.
Three	Piper, Jaffray & Hopwood, Inc.	8-7-69	1,000 shares of Burroughs Corporation	An envelope sent with confirmation of 1,000 shares sold, sent by Piper, Jaffray & Hopwood, Inc.
Four	Dain, Kalman & Quail, Inc.	8-8-69	1,000 shares of Control Data Corporation	An envelope sent with confirmation of 1,000 shares sold, sent by Dain, Kalman & Quail.
Five	Merrill Lynch, Pierce, Fenner, & Smith, Inc.	8-20-69	500 shares of American Research Development	An envelope sent with confirmation of 500 shares sold, sent by Merrill Lynch, Pierce, Fenner, & Smith.

All in violation of Title 15, United States Code, Section 77(q)(a).

COUNTS SIX THROUGH EIGHT

The United States Grand Jury further charges that:

1. Paragraphs 1 through 6 of Count One are realleged herein.

2. On or about the respective dates set forth below in each of Counts Six through Eight, in the District of Minnesota,

NEIL T. NAFTALIN

defendant herein, did, by the use and means or instruments of communication in interstate commerce, more particularly the use of interstate telephone in the offer and sale of securities to each of the respective broker/dealers set forth hereinafter, in Counts Six through Eight, in the manner and means more fully described above, willfully and knowingly, directly and indirectly, employ said device, scheme and artifice to defraud, and did engage in transactions, practices, and a course of business which would and operate as a fraud and deceit upon the respective broker/dealers set forth hereinafter, and said defendant willfully and knowingly, directly and indirectly used the interstate telephone as hereinafter specified:

Count	Date of Telephone Call	Person Initiating Call	Person Called	Security Involved
Six	On or about August 28, 1969	Neil T. Naftalin 1715 1st Natl. Bank Bldg. Minneapolis, MN.	H. S. Kipnis & Co. 209 S. LaSalle St. Chicago, Ill.	1,000 shares of Fairchild Camera & Instrument Corporation
Seven	On or about August 4, 1969	Neil T. Naftalin 1715 1st Natl. Bank Bldg. Minneapolis, MN.	H. S. Kipnis & Co. 209 S. LaSalle St. Chicago, Ill.	500 shares of American Research & Development
Eight	On or about August 1, 1969	Neil T. Naftalin 1715 1st Natl. Bank Bldg. Minneapolis, MN.	H. S. Kipnis & Co. 209 S. LaSalle St. Chicago, Ill.	1,000 shares of Avon Products, Inc.

All in violation of Title 15, United States Code, Section 77(q)(a).

A TRUE BILL

/s/ Richard L. Johnson
Foreman

/s/ Robert G. Renner
United States Attorney

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

No. 4-74-Crim. 73

UNITED STATES OF AMERICA, PLAINTIFF

vs.

NEIL T. NAFTALIN, DEFENDANT

MEMORANDUM

The eight count Indictment charges defendant with violating § 17(a)(1) and (3) of the Securities Act of 1933, 15 U.S.C. § 77(q)(a)(1) and (3),[1] by defrauding

[1] Section 17(a), 15 U.S.C. § 77(q)(a) provides:

"(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."

Willful violations of § 17(a) are made subject to criminal sanctions by § 24 of the Act, 15 U.S.C. § 77x. It reads:

"Any person who willfully violates any of the provisions of this subchapter, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully, in a registration statement filed under this subchapter, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both."

certain broker/dealers in connection with sales of stock made by the broker/dealers for the account of Naftalin & Co., Inc. Defendant has moved to dismiss the entire Indictment because (1) it does not state facts sufficient to constitute an offense against the United States; (2) it improperly alleges a single scheme to defraud under § 17(a)(1) in a multiplicity of counts; and (3) the intentional delay of four and one-half years from the commission of the alleged offenses until the return of the Indictment violates defendant's right to due process of law. Defendant has moved in the alternative for (4) dismissal of Counts I through V for lack of jurisdiction because they fail to allege a sufficient nexus with interstate commerce or the mails; and (5) for dismissal of Counts II through VIII for failure to state an offense because of the absence of the allegation that defendant acted "unlawfully." Additionally, defendant has moved that certain allegations of the Indictment be stricken as surplusage pursuant to Rule 7(d), Fed. R. Cr. P.

I. FACTS SUFFICIENT TO CONSTITUTE AN OFFENSE—

The standards to be applied on a motion to dismiss an Indictment are set forth in *Russell* v. *United States*, 369 U.S. 749 (1961). *Russell* requires that an Indictment contain the essential elements of the offense intended to be charged, adequately apprise the defendant of what he must be prepared to meet, and be sufficiently specific to indicate to what extent a conviction or acquittal upon it would be a defense to a future prosecution on a similar charge. 369 U.S. at 764-765.

Defendant first contends that § 17(a) is directed only to issuers, underwriters, dealers, and individuals associated with the issuers, underwriters or dealers. Defendant notes that the Eighth Circuit held in review of the Naftalin & Co. bankruptcy proceeding that Naftalin & Co. was not a broker/dealer. *In re Naftalin & Co., Inc.*, 469 F.2d 1166 (8th Cir. 1972). Therefore, the argument concludes, defendant cannot be charged under § 17(a).

This argument must be rejected on two grounds. First, the Eighth Circuit's ruling that Naftalin & Co. was not a broker/dealer was for the purpose of determining at what point brokers should have bought-in in order to minimize their losses on stock which they had sold on account for Naftalin & Co., but which Naftalin & Co. never delivered. The Court's ruling does not imply that Naftalin & Co. is not to be considered a broker/dealer in other contexts. It does not negate the allegation in Count I, paragraph 2, of the Indictment that Naftalin & Co. was a registered broker/dealer.

Secondly, this Court interprets "any person" in § 17(a) according to its literal meaning. If Congress had wished to limit this section to issuers, underwriters, brokers, and their staffs, it would have expressly so provided. Instead, Congress drafted a broad remedy that would reach any kind of fraud in the offer or sale of securities. Defendant comes within the class defined by the words "any person."

Defendant next argues that the Indictment fails to state an offense because it does not allege that he defrauded "purchasers" of securities. Section 17(a)(3) is directed to any transaction which operates "as a fraud or deceit upon the purchaser." Defendant contends that it is implicit in each subdivision of § 17(a) that the fraud or misrepresentation affect a purchaser. Defendant's contention relies on *Greater Iowa Corp.* v. *McLendon*, 378 F.2d 783 (8th Cir. 1967), and can be summarized as follows:

> *Greater Iowa* observed: ". . . § 5(a) and § 17(a) were designed primarily for the protection of investors who may purchase the unregistered or fraudulently sold shares. [Citation omitted.]" 378 F.2d at 790. It further stated: "It is our conclusion that private civil liability for violations of § 5(a) and § 17(a) exists only when the provisions of § 12 (15 U.S.C. § 77 1) are met." *Id.* Since § 12 provides that one who makes a misrepresentation in the sale of securities "shall be liable to the person purchasing such security from him," then § 17(a) applies only where a purchaser of securities has been defrauded.

This argument must be evaluated in light of the facts of *Greater Iowa*. The defendants in *Greater Iowa* had established a voting trust in an effort to gain control of the corporation. They issued certificates in the trust in exchange for shares of the corporation. The plaintiffs were the corporation, its directors, and certain shareholders. None of them had subscribed to the voting trust. The Court held that since they had not purchased trust certificates nor "had any semblance of legal privity" (378 F.2d at 790) with the defendants, they had no standing to bring a civil action under § 17(a).

The present case differs from *Greater Iowa* in that the brokers who are alleged to have been defrauded were in privity with defendant and come within the class to be protected by the statute. The Indictment charges that the brokers acted as agents of defendant in selling stocks for him and suffered losses as a direct result of his scheme. In contrast, the plaintiffs in *Greater Iowa* suffered no direct loss. At most, they were threatened with an indirect loss, *i.e.*, loss of control of the Greater Iowa Corporation. *Greater Iowa* does not require dismissal here because protection of brokers from fraudulent short sales schemes comes within the scope of § 17(a).

Reading § 17(a) literally, only subdivision (3) requires that the defrauded party be a purchaser. The acts specified in each subdivision are separate and distinct; each is an "allowable unit of prosecution." *U.S.* v. *Amick*, 439 F.2d 351 (7th Cir. 1971), *cert. den.* 404 U.S. 823, *U.S.* v. *Birrell*, 266 F. Supp. 539 (S.D.N.Y. 1967). Therefore, as to § 17(a)(1), the Indictment is not to be dismissed for failure to allege involvement of a purchaser.

The Government argues that it can satisfy the purchaser requirement of subdivision (3) by proving that the shares sold through H. S. Kipnis & Co. were bought for Kipnis' own account and, alternatively, by proving that defendant's failure to deliver the securities sold forced the other brokers to purchase securities in the market to cover the fraudulent sales. The first of these contentions must be rejected because the Indictment does not allege that Kipnis was a purchaser. "[A] court can-

not permit a defendant to be tried on charges that are not made in the Indictment against him." *Stirone* v. *United States*, 361 U.S. 212, 217 (1960). The second contention must also be rejected in light of the principle that penal statutes are to be strictly construed. Subdivision (3) requires "a fraud or deceit upon the purchaser." The fraud charged was upon the brokers as selling agents. Regardless of the subsequent buy-in, a fraud upon a selling agent as to ownership of the securities sold cannot fairly be construed as a fraud "upon the purchaser." Therefore, the Government will be limited at trial to proof of violations of § 17(a)(1).

II. MULTIPLICITY OF COUNTS—

Defendant contends that the allowable unit of prosecution is the fraudulent course of conduct and that any particular use of the mails or telephone in connection with any particular sale is only a jurisdictional act and not a separate offense. Defendant seeks dismissal of the Indictment or, in the alternative, consolidation into a single count.

Federal Courts have expressed at least four different views as to the allowable unit of prosecution under § 17(a). These views, as summarized by the Seventh Circuit, are set out in a footnote.[2] This Court agrees with the Seventh Circuit's interpretation:

[2] *United States* v. *Amick*, 439 F.2d 351, 359 (7th Cir. 1971), *cert. den.* 404 U.S. 823, summarizes the different views:

> "There is authority for the view (1) that, as is true of mail fraud, each separate use of the mails in the execution of a scheme to defraud in the sale of securities constitutes a separate offense;[11] (2) that each separate offer or sale transaction in which the proscribed conduct is employed and the mails used is the allowable unit;[12] (3) that where an indictment charges employment of proscribed conduct in separate transactions as separate counts, the determination whether there was one offense with several victims or a separate offense upon each victim can ordinarily not be made until proof is in;[13] (4) that where an indictment alleges a scheme to defraud and a number of separate mailings and sales in separate counts, but fails to show that the crime charged in any one count differs from that charged in the others, all counts are to be consolidated and all but one dismissed as separate counts.[14]"
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> * * * *
>
> [FOOTNOTES]
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> "[11] Palmer v. United States (10th Cir., 1956), 229 F.2d 861, 867, cert. den. 350 U.S. 996, 76 S.Ct. 546, 100 L.Ed. 861.
>
> "[12] Sanders v. United States (5th Cir., 1969), 415 F.2d 621, 626; United States v. Saporta (E.D.N.Y., 1967), 270 F. Supp. 183, 186. In this circuit it has been said that 'the government must show some impact of the scheme on the investor and that the mails were used in those instances where the impact occurred.' United States v. Schaefer (7th Cir., 1962), 299 F.2d 625, 629.
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> "[13] United States v. Birrell (S.D.N.Y., 1967), 266 F. Supp. 539, 544.
>
> "[14] United States v. Hughes (S.D.N.Y., 1961), 195 F. Supp. 795, 798."

> "[W]here an indictment charges employment of proscribed conduct in separate transactions as separate counts, the determination whether there was one offense with several victims or a separate offense upon each victim can ordinarily not be made until proof is in." *U.S.* v. *Amick*, 439 F.2d 351, 359 (7th Cir. 1971), *cert. den.* 404 U.S. 823.

The counts of this Indictment charge not only separate mailings but also separate sales. The Court cannot conclude as a matter of law that the Government will be unable to prove separate and distinct offenses. Therefore, defendant's motion must be denied at this time. It may be renewed at the close of trial.

III. DELAY PRIOR TO INDICTMENT—

The sales on which the Indictment is based are alleged to have taken place in August 1969. Defendant states that the Securities and Exchange Commission began an investigation of these sales in October 1969; that the SEC ascertained the essential facts of the present Indictment no later than November or December 1969; that before this Indictment was sought, the SEC participated in a

civil action,[3] a bankruptcy appeal,[4] and an administrative proceeding,[5] all of which concerned the same facts alleged in the Indictment. Defendant argues that the SEC's involvement in these non-criminal proceedings over a four and one-half year period prior to the Indictment has violated defendant's Fifth Amendment guarantee of due process of law.

To support these claims, defendant sought in May 1974 (1) discovery of correspondence between brokers or the New York Stock Exchange and the SEC, the Federal Reserve Board, or the Justice Department concerning the subject matter of the present Indictment; and (2) discovery of internal documents of the SEC, Federal Reserve Board, and the Justice Department concerning investigation and institution of prosecution in the present case. The Magistrate denied these requests for discovery in his Order of June 4, 1974. That denial was based on *United States* v. *Emory*, 468 F.2d 1017 (8th Cir. 1972), in which the Court of Appeals ruled that a showing of substantial prejudice beyond a bare claim of faded memories was essential to establishing a violation of due process through pre-Indictment delay. This Court summarily affirmed the Magistrate's Order in its Order of July 29, 1974.

Subsequent to the July 29 Order, defendant submitted an affidavit stating that he would be prejudiced by the delay because of the death on April 1, 1972, of John M. Dryfoos, a senior partner in a New York brokerage firm. According to the affidavit, Dryfoos would have testified that Naftalin & Co. bought substantial amounts of securities from his firm in 1968 and 1969; that on many occasions immediate delivery of the securities was provided; and that Naftalin & Co. maintained its account in good standing. Defendant apparently contends that Dryfoos' testimony would be relevant to the issue of intent to defraud. Assuming for the purpose of the present motion that Dryfoos' testimony would have been relevant, the

[3] *SEC* v. *Naftalin & Co.*, No. 4-69-Civil 385 (D. Minn. 1969).

[4] *In re Naftalin & Co.*, 469 F.2d 1166 (8th Cir. 1972).

[5] *In re Naftalin & Co.*, SEC File No. 3-3277 (1971).

Court finds that the dealings about which Dryfoos would have testified can be established from the records of the Naftalin and Dryfoos brokerage firms. (See Government's Brief at p. 3.) The Court again concludes that defendant has failed to demonstrate substantial prejudice under the *Emory* standard.

Since the present motions were taken under advisement in September, two decisions have been handed down which suggest reconsideration of the denial of the discovery requests. In *United States* v. *Jackson*, No. 74-1045 (8th Cir.) decided September 13, 1974, the Court of Appeals by Judge Heaney rejected a claim that a pre-Indictment delay had violated due process. The Court in *Jackson* relaxed the *Emory* requirement that an affirmative showing of substantial prejudice was essential for a finding of a violation of due process:

> "It is often said that unreasonable delay must coincide with prejudice before the due process clause requires reversal and hence many courts after finding lack of prejudice, refuse to consider the reasons for delay . . . .
>
> "Since we prefer to view the due process claim as one involving a balancing process, we hesitate to say that prejudice could never be presumed in an outrageous case of unjustified delay." *United States* v. *Jackson*, *supra*, slip op. at 3-4 n.2 (citations omitted).

In *United States* v. *U.S. Gypsum Co.*, 43 U.S.L.W. 2194 (W.D. Pa. Oct. 21, 1974), the Court ordered the Government to produce all internal memoranda from a 13 year period relevant to the claim that the Government had intentionally delayed prosecution on criminal antitrust charges in order to impair the defense. "[R]ecognizing that proof of this [intentional delay] could be found only in the Government's files, if, indeed, it existed at all," the Court ordered production of "all material which might have any bearing on the point [defendants] wish to prove." 43 U.S.L.W. at 2195. After in camera examination of "a mountain" of Antitrust Division and FTC internal memoranda, the Court concluded that the docu-

ments exonerated the prosecution of all claims of impropriety.

Under *Jackson* an affirmative showing of substantial prejudice is not essential for a finding of a due process violation (1) in a case where the Government has engaged in intentional delay in order to gain a tactical advantage or (2) in other outrageous cases of unjustified delay. The Eighth Circuit in an earlier order in *Jackson* had remanded the case with instructions for the District Court to make findings as to the reasons for the eleven month delay between the offense and the Indictment. In the present case, 55 months passed between the time the brokers became aware of the allegedly fraudulent transactions and the bringing of the Indictment. On the basis of prior proceedings against Naftalin & Co. arising out of the same transactions, defendant suggests that the Government was aware of the facts alleged in the Indictment as much as four and one-half years before the indictment was brought. The Government has not disputed this inference nor offered any justification for the apparent delay in instituting prosecution.

The appropriate procedure for resolving claims of unjustified pre-Indictment delay and of intentional delay for tactical advantage is that followed in *U.S. Gypsum.* Faced with similar defense motions arising out of a five year delay between initial investigation and presentation to the grand jury, the Court in *U.S. Gypsum* ordered production of all relevant Government documents for in camera inspection. Subsequently, the Court allowed defense inspection of the documents. This Court will, therefore, order production of certain Government documents for in camera inspection and reserve decision until after the inspection on whether the documents will be disclosed to the defense and on whether an evidentiary hearing will be required. The documents to be produced are those requested in paragraph 14, subdivisions (a), (b), and (c), of defendant's Motion for Discovery and Inspection, filed May 17, 1974:

> "14. All records in the possession, custody or control of the Government, including specifically the SEC and the Federal Reserve Board, from which the following information can be determined:

> (a) The date or dates on which, and the manner in which, any of the matters alleged in the Indictment relating to transactions of Naftalin & Co., Inc., or the activities of the defendant, during the period from July through October 1969, first came to the attention of the SEC, the Federal Reserve Board, the Department of Justice and any United States Attorney.
>
> (b) The nature, extent and duration of the investigative activity undertaken by the SEC and the Federal Reserve Board relating to such matters, together with the dates and nature of any resulting actions taken or recommendations made.
>
> (c) The nature and extent of the information generated by such investigative activities which was thereafter provided or made available to any other agency of the Government, including the Justice Department or any United States Attorney, together with the dates on which the information was provided or made available."

IV. COUNTS I-V: JURISDICTIONAL ACT—

Defendant contends that the jurisdictional requirement of use of the mails or other instrumentalities of commerce is not satisfied by the allegations that the defrauded brokers used the mails to send defendant confirmation of his sales. Defendant maintains that these mailings are so remote from the alleged scheme that they do not support Federal jurisdiction. In support of this contention, defendant cites *Getchell* v. *United States*, 282 F.2d 681 (5th Cir. 1960). In *Getchell*, the mailing upon which jurisdiction under § 17(a) was alleged concerned the form in which subscribers wished their certificates to be made out. It contained no offers, promises, or representations. The Fifth Circuit reversed three convictions based on this mailing. Defendant interprets these reversals as signifying that a conviction under § 17(a) requires that the mails be employed directly in the scheme to defraud.

Although not without ambiguity, the result in *Getchell* appears to be based on the Government's failure to prove the particular use of the mails set out in the Indictment. 282 F.2d at 684. The Court noted that the "question of statutory construction need not be decided in this case." *Id.* This Court does not find *Getchell* persuasive authority for defendant's contention.

The Government cites *United States* v. *Cashin*, 281 F.2d 669 (2nd Cir. 1960), as supporting jurisdiction in the present case. In affirming a conviction under § 17(a), *Cashin* observed (281 F.2d at 674):

> "No claim is made that the fraudulent matter was mailed or even that the mailings alleged were necessary to the execution of the unlawful scheme. In fact, the only alleged use of the mails was to confirm purchases already induced by the defendant's deceit."

In *Cashin* the defendant was charged with fraud in the sale of securities and jurisdiction was based on his mailing of confirmations of the sales. In the present case, defendant Naftalin did not mail confirmations but received confirmations mailed by the brokers. The Indictment charges that defendant "caused" these confirmations to be mailed. The connection between the scheme and the use of the mails is weaker in the present case than in *Cashin*.

The Court of Appeals for the Eighth Circuit has held that the jurisdictional act requirement of § 17(a) is to be construed broadly. *Little* v. *United States*, 331 F.2d 287 (8th Cir. 1964), *cert. den.* 379 U.S. 834, sustained a conviction under § 17(a) in which the jurisdictional act was defendant's deposit of the duped investors' checks in a Memphis bank with knowledge that the checks would move through interstate commerce to the Federal Reserve Bank in St. Louis. In holding that defendant "caused" the checks to move in interstate commerce, the Court relied on a Supreme Court decision concerning mail fraud:

> " 'Where one does an act with knowledge that the use of the mails will follow in the ordinary course of business, or where such use can reasonably be foreseen, even though not actually intended, then he "caused" the mails to be used.' " *Pereira* v. *United States*, 347 U.S. 1, 8-9 (1954), quoted in *Little*, *supra*, at 293.

Little noted that "Congress intended to assert its full constitutional power" in enacting the jurisdictional provisions of the Securities Act of 1933, and that a prosecution under § 17(a) may be sustained if the mail is "used in employing the scheme however incidental the mailing may be. [Citation omitted.]" 331 F.2d 292-293.

As an experienced trader in securities, defendant would have known that a confirmation by mail would follow each of the sales listed in the Indictment. The Indictment adequately alleges that defendant "caused" the confirmations to be mailed. These confirmations are incidental to the scheme charged and, under *Little*, will support jurisdiction under § 17(a).

V. "UNLAWFULLY" AS NECESSARY ELEMENT OF COUNTS II THROUGH VIII—

Defendant contends that since § 17(a) uses the word "unlawful," an Indictment thereunder is fatally defective unless it alleges that the defendant acted "unlawfully." This contention is without merit. The section reads: "It shall be unlawful for any person . . . ." "Unlawful" is not an element of the proscribed conduct; it only introduces what is proscribed. The Court holds it is not necessary for the Indictment to allege that defendant acted "unlawfully."

VI. SURPLUSAGE—

Defendant requests that two portions of Count I in the Indictment be stricken as surplusage: (1) the allegation in paragraph 2 that Naftalin & Co. was a registered broker/dealer and a member of the National Association of Securities Dealers; (2) the allegations in paragraph 6 that defendant made false and misleading statements to the selling brokers after the due dates for delivery of the

stock sold. In support of the first request, defendant relies on the Eighth Circuit's treatment of Naftalin & Co. as an ordinary investor in *In re Naftalin,* 469 F.2d 1166 (8th Cir. 1972). As discussed in Part I of this memorandum, this Court does not read the characterization of Naftalin & Co. by the Eighth Circuit as applying outside the context of Regulation T. Therefore, the Government is not foreclosed from proving that Naftalin & Co. was a broker/dealer. Such proof would be relevant to defendant's understanding of securities trading practices and, thereby, to defendant's intent. The allegation is not surplusage.

Defendant contends that subsequent misrepresentations are not material to a violation of § 17(a) because the section is directed only to fraudulent schemes "in the offer and sale of securities." The Government argues that these misrepresentations were part of the on-going scheme to defraud the selling brokers. It cites *Walters* v. *United States,* 256 F.2d 840 (9th Cir. 1958), *cert. den.* 358 U.S. 833, in which the Ninth Circuit approved the giving of the following instruction by the District Court in a § 17(a) prosecution:

> "A scheme to defraud may well include later efforts to avoid detection of the fraud. Avoidance of detection and prevention of recovery of property fraudulently obtained may be a material part of an illegal scheme." 256 F.2d at 843.

By negative implication, the quoted passage suggests that an effort to avoid detection will not in every situation be deemed a material part of an illegal scheme. It is necessary to view the total scheme charged to determine if the subsequent acts are so related as to be part of the offense.

Count I, paragraph 5, of the present Indictment alleges that defendant sought through his scheme to effect short sales of the stock sold. The inference which follows from paragraph 5 is that defendant would at a later date close out the short sales by buying and delivering the necessary stock certificates. The closing out of the short sales is part of the total scheme. The statements alleged in paragraph 6 were intended to placate the selling brokers until defendant could complete his scheme by buying and delivering the stock certificates. The Court concludes that these statements are a material part of the total scheme with which defendant is charged. The motion to strike paragraph 6 of Count I must be denied.

/s/ Earl R. Larson
EARL R. LARSON
United States District Judge

January 28, 1975.

SUPREME COURT OF THE UNITED STATES

No. 78-561

UNITED STATES, PETITIONER

v.

NEIL T. NAFTALIN

ORDER ALLOWING CERTIORARI. Filed December 11, 1978

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

UNITED STATES OF AMERICA,
Petitioner,

vs.

NEIL T. NAFTALIN,
Respondent.

No. 78-561

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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OCTOBER TERM, 1978

No. 78-561

UNITED STATES OF AMERICA,

Petitioner,

vs.

NEIL T. NAFTALIN,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

Respondent, for the reasons stated herein, prays that the Court deny Petitioner's request for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this matter.

QUESTION PRESENTED

Whether Section 17(a)(1) of the Securities Act of 1933 prohibits the short sale of securities where the seller fails to disclose the sales are "short" or misrepresents the sales as "long" to brokers acting as agents for the seller, and where the investors who purchase the sold securities are neither deceived nor damaged.

STATUTES INVOLVED

1. Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. §77q(a)(1), provides in part:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud . . .

2. Section 2(3) of the Securities Act of 1933, 15 U.S.C §77b(3) provides in part:

> The term "sale" or "sell" shall include every contract of sale or disposition of a security or interest in a security, for value. The term . . . "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

STATEMENT OF CASE

In 1969 Respondent was the principal of a registered broker/dealer who allegedly engaged in a fraudulent scheme by placing orders with five different brokers in eight separate transactions to sell stock listed on the New York Stock Exchange. Allegedly Respondent did not own such stock at the time of the orders and was selling "short" either without disclosing such fact or by misrepresenting that the sales were "long" to the brokers.[1] The brokers were acting as Respondent's agents for the purpose of

[1]A "short sale" means any sale of a security which the seller does not own. Rule 3b-3, 17 C.F.R. §240.3b-3. A "long sale" by general usage is considered to be a sale of a security which the seller owns.

finding buyers for the stock and transferring the stock to them (Petition, App. A, 2a).[2]

It had been Respondent's practice to deliver securities to his brokers weeks or months after the settlement dates for his sales (Petition, App. A, 3a).[3] When Respondent would not deliver the sold securities by their settlement date his brokers would nevertheless make delivery to purchasers of the securities by borrowing or purchasing the securities.[4] By permitting such delays while they covered Respondent's sales, the brokers were extending credit to Respondent and were very likely violating Section 7(c) of the Securities Act of 1934 (the "1934 Act"), 15 U.S.C. §78g(c), and Regulation T, 12 C.F.R. §220.1, promulgated thereunder by the Board of Governors of the Federal Reserve Board.[5]

[2]Count VI of Respondent's indictment related to sales to a brokerage firm acting as a principal on its own behalf. Count VI was dismissed by the Eighth Circuit because it did not charge that Respondent had defrauded any purchasers". Petitioner has not raised the dismissal of Count VI on this ground as a question presented for review.

[3]*Naftalin & Co., Inc v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166, 1175 n. 10 (8th Cir. 1972).

[4]*Id.* at 1171.

[5]*Id.* at 1176.

Section 7(c) provides in part:

> It shall be unlawful for . . . any broker or dealer, directly or indirectly to extend or maintain credit or arrange for the extension or maintenance of credit to or for any customer—
>
> (1) on any security (other than an exempted security), in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe under subsections (a) and (b) of this section. . . .

Respondent's sales were transacted through "special cash accounts" with his brokers. Under Regulation T sales in such accounts may be made only if the sold securities are already held in the customer's account or if in good faith the broker/dealer believes the securities will be promptly delivered to the account. Specifically, Regulation T states that a broker/dealer may in a special cash account: such an account:

> Sell any security for . . . a customer provided the security is held in the account or the [broker/dealer] is informed that the customer or his principal owns the security and the . . . sale is in reliance upon an agreement accepted by the [broker/dealer] in good faith that the security is to be *promptly* delivered in the account.

12 C.F.R. §220.4 (Emphasis added).

Ultimately, Respondent never delivered to his brokers any stocks for the sales which were the basis of Respondent's indictment. The Circuit Court below found that the indictment transactions resulted in loss to Respondent's brokers.[6] However, all investors who purchased stock sold by Respondent received such stock and there was no evidence that any third party investors were deceived or defrauded in any way (Petition, App. A, 5a). The Eighth Circuit further found that as between Respondent and the brokers there were no offers or sales of securities. (Petition, App. A. 6a).

Respondent disclosed to the brokers and the Securities and Exchange Commission (the "SEC") in October, 1969, that Respondent was unable to deliver the stocks he had sold. Thereafter occurred an outrageous delay of four and one-half years[7] before Respondent was indicted under Section 17(a)(1) of the Securities Act of 1933 (the "1933 Act"). During this hiatus the government, through the SEC, participated in various proceedings related to Respondent's alleged short selling.[8] Due to such delay the trial

[6]After Respondent's disclosure of his inability to deliver stocks pursuant to his sell orders, the brokers themselves purchased the particular stocks and suffered losses due to rises in the market for such stocks since their dates of sale.

[7]*United States v. Naftalin*, 534 F.2d 770, 771 (8th Cir. 1976).

[8]The indictment transactions have been part of the subject matter of (1) a civil injunctive action (*SEC v. Naftalin & Co., Inc.*, 4-69 Civ. 385 (D. Minn. November 9, 1969); 460 F.2d 471 (8th Cir. 1972)); (2) involuntary bankruptcy proceedings (*In Re Naftalin & Co., Inc.*, 4-70 Bky. 137, 170 (D. Minn. February 10, 18, 1970); 315 F. Supp. 463 (D. Minn. 1970); 333 F. Supp. 136 (D. Minn. 1971); 469 F.2d 1166 (8th Cir. 1972)); (3) private civil actions (*H. S. Kipnis & Co. v. Naftalin & Co., Inc.*, 4-70 Civ. 408 (D. Minn. October 1, 1970); *Merrill, Lynch, Pierce, Fenner & Smith, Inc. v. Naftalin & Co., Inc.*, 4-70 Civ. 458 (D. Minn. October 23, 1970); *Faulkner, Dawkins & Sullivan v. Naftalin & Co., Inc.*, 4-71 Civ. 33 (D. Minn. January 29, 1971)); and (4) SEC disciplinary proceedings (*In the Matter of Naftalin & Co., Inc. and Neil T. Naftalin*, SEC File No. 3-3272 (September 30, 1971)).

court dismissed Respondent's indictment. On appeal to the Eighth Circuit, however, the indictment was reinstated.[9]

Finally, a jury having been waived, this matter was heard in December, 1976 and Respondent convicted on all indictment counts. On appeal to the Eighth Circuit, Respondent's indictment was dismissed in its entirety. The Court reasoned that the "species of fraud" of which Respondent was accused was not prohibited by Section 17(a)(1). The court concluded that under such statute "the government must prove some impact of the scheme on an investor" (Petition, App. A, 8a).

REASONS FOR DENYING WRIT

Petitioner attempts to dignify the narrow issue presented in this matter by casting it as one potentially affecting all "intermediaries" in securities transactions and as one "essential to the securities marketplace" (Petition at 6). Such largess in characterization of the issue is belied by the fact that in the forty-five years since enactment of Section 17(a) this case is apparently the first reported decision in which the issue, even as framed by the government, has been directly confronted.[10] When the issue is properly framed as merely involving the question of whether Section 17(a)(1) proscribes nondisclosures or misrepresentations to a seller's own agent concerning short sales, in the absence of actual or intended injury to investors, the true ramifications of this matter are revealed.

[9]*United States v. Naftalin*, 534 F.2d 770 (8th Cir. 1976) *cert. denied* 429 U.S. 827 (1977).

[10]Petitioner's contention that the decision below is in conflict with *United States v. Brown*, *infra* is wholly unsupportable as discussed *infra*.

A. Jurisdiction of this Court is Sought Merely to Rectify the Government's Error in Bringing Respondent's Indictment Under the Wrong Statute.

This matter is before the Court solely due to a mistake of the government—a mistake apparently born of belated haste to bring an indictment against Respondent prior to the running of a statute of limitations.[11] Simply stated, the government selected the wrong federal securities statute under which to bring Respondent's indictment.

At the time of Respondent's indictment it was well recognized that Section 10(b) of the 1934 Act, 15 U.S.C. §78j(b) and Rule 10b-5, 17 C.F.R. §240.10b-5 promulgated thereunder, offered more expansive prohibitions on fraud and deception.[12] In particular, the stage had already been set for a possible criminal indictment of Respondent under these provisions by the government's successful prosecution in *United States v. Peltz*, 433 F.2d 48 (2d Cir. 1970). There a conviction was upheld under Section 10(b) and Rule 10b-5 based on the defendant's false statements to brokers that his stock sales were long when in fact he was selling short.

At the time of Respondent's indictment, authority also existed under which the government might well have chosen to indict Respondent for a violation of Section 10(a) of the 1934 Act, 15 U.S.C. §78j(a), or rules thereunder, which expressly regulate short selling.[13] *See United States v. Peltz, supra* at 54; *see also United States v. Mandel*, 296 F.Supp. 1038 (S.D.N.Y.1969).

B. Respondent's Indictment Is Based On Stale Factual Events Unlikely of Repetition.

This matter is now one of only historical interest, and one turning on unique facts involving sophisticated brokers who, if not in actual violation of the credit extension provisions of Regulation T, at least had far less than clean hands.[14] More than nine years have passed since the indictment transactions and there is a decided staleness about this matter. This is especially true in view of subsequent securities regulations which have substantially eliminated the probability that events similar to those giving rise to Respondent's indictment will be recurring.

Specifically, it should be understood that Respondent's

[11]See *United States v. Naftalin*, 534 F.2d 770, 772 (8th Cir. 1976).

[12]Section 10(b) of the 1934 Act states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, promulgated under Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) to employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

[13]Section 10(b) of the 1934 Act provides in part:

> It shall be unlawful for any person . . . .
>
> (a) To effect a short sale . . . of any security registered on a national securities exchange, in contravention on such rules and regulations as the Commission may prescribe . . . .

[14]*See Naftalin & Co., Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., supra.*

brokers were damaged due to their own tardiness in covering Respondent's sales.[15] Since the time of Respondent's transactions, Rule 15c3-3(m), 17 C.F.R. §240.15c3-3 (m), has been adopted by the SEC. This rule now requires a broker/dealer to buy-in for the account of a seller if within 10 business days after settlement date for a sale the broker/dealer has not obtained possession of the sold securities "for any reason whatsoever".

In the intervening years additional regulations directed against transactions such as those attributed to Respondent have been enacted and promulgated in the form of Section 7(f) of the 1934 Act, 15 U.S.C. §78g(f), and Regulation X, 12 C.F.R. §224.1. These provisions make it unlawful for a customer to obtain extensions of credit from a broker/dealer in contravention of Regulation T.[16]

C. Other Effective Remedies Are Available for Deceptive Short Selling Which Damages Brokers of the Seller.

Petitioner argues that an expansive reading of Section 17(a)(1) beyond its intended scope is necessary in order to

[15] *Id.*

[16] Prior to Regulation X only brokers/dealers had the "onus of complying" with Regulation T. *Naftalin & Co., Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., supra* at 1182.

Section 7(f) of the 1934 Act states in part:

> It is unlawful for any United States person . . . to obtain, receive or enjoy . . . extension of credit from any lender . . . for the purpose of (A) purchasing or carrying United States securities, if under this section or rules and regulations prescribed thereunder, the loan or other credit transaction is prohibited . . . .

Regulation X, promulgated under Section 7(f), states in part:

> §224.2(a) A borrower shall not obtain any purpose credit from within the United States unless he does so in compliance with the following conditions:
>
> . . .
>
> (2) Credit obtained from a broker/dealer shall conform to the provisions of Part 220, (Regulation T) . . . .

supply the SEC with effective armament. Such argument should have a familiar ring. In *SEC v. Sloan*, —, U.S. —, 56 L.Ed.2d 148 (1978), the Court rejected a similar argument that Section 12(k) of the 1934 Act, 15 U.S.C. §781(k), should be interpreted beyond its language and intent in order to allow the SEC to issue successive trading suspension orders. The SEC argued that other remedies available to it were ineffective. Such position, however, was chastized and aptly characterized by the Court:

> Even assuming, however, that a totally satisfactory remedy—at least from the Commission's viewpoint—is not available in every instance in which the Commission would like such a remedy, we would not be inclined to read §12(k) more broadly than its language and the statutory scheme reasonably permit. Indeed, the Commission's argument amounts to little more than the notion that §12(k) *ought* to be a panacea for every type of problem which may beset the marketplace.

Id. 56 L.Ed.2d at 1160.

In addition to possible enforcement actions now available under Section 7(f) of the 1934 Act against a seller unlawfully obtaining credit from a broker in a short sale, as noted above, enforcement is also available under Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. *United States v. Peltz, supra.* As admitted by Petitioner, these provisions have already been recognized to protect more than investors (Petition at 9, n. 10). *See A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 396-397 (2d Cir. 1967). This Court in *Superintendent of Insurance v. Bankers Life and Casualty Co.*, 404 U.S. 6, 12 n. 8 (1971) expressly noted that the legislative history of the

1934 Act was especially concerned with the impact of fraud on creditors.[17] Additionally, prosecution of securities fraud has frequently been brought under the mail fraud statute 18 U.S.C. §1341.[18] *See, e.g., U.S. v. Ashdown,* 509 F.2d 793 (5th Cir. 1975).

It should also be noted that SEC action is not the exclusive vehicle for redress from fraud in connection with securities transactions. For example, civil remedies are available under state law or the common law. *See SEC. v. Sloan, supra,* 56 L.Ed.2d at 159; *see also Blue Chip Stamps v. Manor Drug Stores, supra* at 738 n. 9. And if the SEC finds itself so insecure as to its power to regulate deceptive short selling, the SEC need only promulgate ad-

[17]Petitioner suggests that remedies under Rule 10b-5 may be undermined by the case at bar. Such a position ignores the fact that, as this Court has noted, the purpose and legislative history of the 1933 Act, in which Section 17(a)(1) is found, are quite distinguishable from those of the 1934 Act, under which Section 10(b) was enacted. The 1934 Act is general in scope and chiefly concerned with securities trading, whereas the 1933 Act is far narrower. *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 752 (1975); *see also Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 195 (1976). Further, the very language of Section 10(b) bespeaks an intent to protect more than investors. The provision prohibits activities in contravention of such rules and regulations as the SEC may prescribe "in the public interest" *or* "for the protection of investors". With a proscription of fraud "in connection with" a securities sale, rather than merely "in" a sale (as found in Section 17(a) of the 1933 Act), Section 10(b) is a "catch-all" against fraud related to securities transactions. *See Ernst & Ernst v. Hochfelder, supra* at 203.

[18]18 U.S.C. §1341 states in part:

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Post Office Department, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both.

ditional regulations pursuant to Section 10(a) of the 1934 Act, which authorizes SEC regulation of short sales.

D. The Circuit Court's Decision is Consistent with the Language of Section 17(a)(1), Its Legislative Purpose and Prior Court Decisions.

The very face of Section 17(a)(1) plainly reflects that the statute affords protection only to investors. Only fraud "in" the sale of securities is prohibited.[19] A sale is defined to include "every contract of sale or disposition of a security." 15 U.S.C. §77b(3). The brokers who were allegedly deceived were not parties to any contract for sale or any disposition of securities, they were merely agents acting on behalf of Respondent. Only the actual purchasers of Respondent's sold securities were parties to Respondent's sales. However, such purchasers were neither deceived nor defrauded. Hence, there could have been no fraud "in" Respondent's sales.[20]

The Eighth Circuit's decision below is not only supported by the plain language of Section 17(a)(1), but by the Circuit Court's review of the legislative history of the 1933 Act. This history revealed a design to protect in-

[19]Petitioner on appeal chooses to focus on the fact that Section 17(a)(1) also proscribes fraud in the "offer" of a security (Petition at 7). Such approach does not surmount the basic obstacle that the Respondent did not either sell or make any offer to his brokers (Petition, App. A, 6a), Thus, there could have been no fraud "in" any offer. Further, the trial court found only that fraud had occurred in the actual "sale" of securities, with no reference to any offers (Petition, App. D, 20a). An offer is not included within the meaning of a "sale". *Blue Chip Stamps v. Manor Drug Stores, supra* at 733 n. 5.

[20]The language of Section 17(a) is to be sharply contrasted with the language of Section 10(b) under the 1934 Act and Rule 10b-5 which both broadly refer to fraud "in connection with" a sale of securities.

vestors only (Petition, App. A, 7a-8a).[21] Applying the strictures of Section 17(a)(1) only in cases of investor fraud is also consistent with the scope of other fraud provisions in the 1933 Act, such as Sections 11(a) and 12, 15 U.S.C. §§77k(a), 771, which establish civil liability only in the case of defrauded purchasers.[22]

Notwithstanding the unambiguous language of Section 17(a)(1) and the legislative policy and statutory scheme of the 1933 Act, Petitioner urges an expansion of Section 17 (a)(1) in view of the remedial purposes of the securities acts and in order to proscribe all potentially fraudulent activities. However, "this approach [is] unsatisfactory in its focus on situations that [Section 17(a)(1)] may not reach rather than on the language and purpose of the . . . provision itself."[23] *Foremost-McKesson, Inc. v. Provident Se-*

[21]By enacting the 1933 Act Congress sought:

> . . . To prevent further exploitation of the *public* by the sale of unsound, fraudulent and worthless securities through misrepresentation; to place adequate and true information before the *investor;* to protect honest enterprise . . . against the competition afforded by dishonest securities offered to the *public* through crooked promotion; to restore the confidence of the prospective *investor* in his ability to select sound securities . . .

S. Rep. No. 47, 73rd Cong., 1st Sess. 1 (1933) (Emphasis added).

[22]It is of interest to note that in *Piper v. Chris-Craft Indutsires, Inc.*, 430 U.S. 1, *reh. denied* — U.S. —, 52 (1977) this Court expressly acknowledged that certain provisions of the federal securities laws are designed and intended only to protect investors. There the Court held that a tender offeror did not have standing to sue for damages under Section 14(e) of the 1934 Act, 15 U.S.C. §77n(e), because the statute was designed to protect only investors who might be confronted with a tender offer.

[23]Petitioner's reliance on *United States v. Culbert*, — U.S. —, 55 L. Ed. 2d 349 (1978) is particularly misplaced. This decision is readily distinguishable since there defendant argued for a restriction as to the scope of a criminal statute where the statute was patently applicable and the argument was unsupported by the legislative history of the act.

curities Co., 423 U.S. 232, 244 (1976).[24] The Court should also be mindful of the well established rule that penal statutes are strictly construed. *Mourning v. Family Publication Service,* 411 U.S. 356, 375 (1973).

Petitioner has also attempted to manufacture a conflict between the Eighth Circuit's decision below and other cases. This endeavor is doomed, however, since this matter presents a case of first impression (Petition, App. A, 9a). Further, such decisions as are of any relevance to this matter, are consistent with the Eighth Circuit's conclusions. For example, although not in the short selling context, both the Fifth and Seventh Circuits have recognized that a required element for prosecution under Section 17 (a) is proof of an impact upon the investor:

> Specific reliance by the investor need not be shown in a prosecution under 15 U.S.C. §77(q)(a). Rather, what must be shown is that the scheme had an impact on the investor and that the mails were used in employing the scheme.

United States v. Ashdown, 509 F.2d 793, 799 (5th Cir. 1975); *Accord, United States v. Schaefer,* 299 F.2d 625, 629-30 (7th Cir. 1962).

The sole decision cited by Petitioner as a basis for an alleged conflict, *United States v. Brown*, 555 F.2d 336 (2d Cir. 1977), does not represent a conflict with the pending matter since the species of fraud involved there was

[24]In *Foremost-McKesson* a liberal interpretation was urged as to the scope of Section 16(b) of the 1934 Act, 15 U.S.C. §78p(b), which permits actions by an issuer for disgorgement of profits reaped by an insider's "short-swing" trading. Earlier expansive interpretations of Section 16(b) by circuit courts were expressly rebuked by the Supreme Court since "in none of the [Circuit Court] cases did the court examine critically the legislative history." 423 U.S. at 242. The Court was also unpersuaded by the contention that a restrictive interpretation of the statute would make it "inapplicable to some possible abuses." *Id.* at 244.

actually perpetrated against an investor. The defendant had counterfeited stock owned by a particular investor, thereby converting the investor's stock. *Id.* at 339. The Second Circuit expressly pointed out that the scheme included "a massive assault upon innocent investors." *Id.*

As a final backstop position, Petitioner apparently argues that investors in some manner are in fact injured if a broker suffers loss from a short sale buy-in. Petitioner argues that the risk of loss to the broker is ultimately shifted to the investing public by way of increased commissions or otherwise. Such position fails to acknowledge that civil and criminal actions may be brought other than under Section 17(a)(1) such that the case at bar imposes no additional risk of unrecouped loss to brokers. Additionally, with the buy-in requirements now imposed on sales transactions by Rule 15c3-3(m), any risk of significant buy-in losses is largely ameliorated.

CONCLUSION

The petition for a writ of certiorari in this matter should be denied.

Respectfully submitted,

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OCTOBER TERM, 1978

UNITED STATES OF AMERICA, PETITIONER

v.

NEIL T. NAFTALIN

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES

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CITATIONS

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-561

UNITED STATES OF AMERICA, PETITIONER

v.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a–11a) is reported at 579 F.2d 444. The opinion of the district court (Pet. App. 15a–20a) is not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 12a–13a) was entered on June 13, 1978. A timely petition for rehearing was denied on August 4, 1978 (Pet. App. 14a). On August 31, 1978, Mr. Justice Blackmun extended the time for filing a petition for a writ of certiorari to and including October 3, 1978. The petition was filed on October 2, 1978, and was granted

on December 11, 1978. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether Section 17(a)(1) of the Securities Act of 1933 prohibits fraudulent practices that injure brokers who serve as intermediaries in the offer or sale of securities but who are not themselves investors.

STATUTORY PROVISIONS INVOLVED

1. Section 17(a)(~~1~~) of the Securities Act of 1933, 15 U.S.C. 77q(a)(~~1~~), provides in part:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud * * * [or]
>
> * * * * *
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.
>
> * * * * *

2. Section 2(3) of the Securities Act of 1933, 15 U.S.C. 77b(3), provides in part:

> The term "sale" * * * shall include every contract of sale or disposition of a security or interest in a security, for value. The term * * * "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

STATEMENT

1. Respondent was the president of Naftalin & Co., Inc., a registered broker-dealer firm operating in Minneapolis, Minnesota. From 1966 to 1969 respondent engaged in a "short selling" scheme. Respondent studied the prices of selected securities and when, in his judgment, those prices had peaked and were entering into a period of decline, he placed large sell orders with other brokers. When placing such orders, respondent either stated or implied that he owned the shares to be sold, *i.e.*, that the sales were "long." In fact, however, all the sales were "short;" respondent did not own any of the securities that he purported to sell (Pet. App. 16a–18a). The success of respondent's scheme depended on the accuracy of his predictions that the market prices of the securities would decline before he was required to deliver them. Respondent planned to buy the securities at lower prices and to take as profit the difference between the price at which he sold and the price at which he covered (*id.* at 2a–5a).

Between July and August 1969 respondent placed eight sell orders for securities listed on the New York Stock Exchange.[1] Because respondent had "cash

[1] Respondent placed sell orders for 500 shares of American Research and Development Company stock and 1,000 shares of Burroughs Corporation stock with Paine, Webber, Jackson and Curtis; 1,000 shares of Burroughs Corporation stock with Piper,

accounts" with the five brokerage firms that accepted the orders (Pet. App. 16a–17a), he was not permitted to engage in short selling.[2] If the brokers had known that respondent was selling short, they either would not have accepted his orders or would have insisted on the creation of a general account with the margin deposit required by law (Tr. 81–82, 141, 209, 238, 288–289, 357). To conceal the fact that he was selling short, respondent either expressly stated or implied that his sales were long (Tr. 19, 21, 67–69, 120–123, 152–153, 237–243, 314, 353–360). With only one exception,[3] the brokers executed the sell orders on the New York Stock Exchange by making sales marked

Jaffray & Hopwood, Inc.; 1,000 shares of Control Data Corporation stock with Dain, Kalman and Quail, Inc.; 500 shares of American Research and Development Company stock with Merrill Lynch, Pierce, Fenner and Smith, Inc.; and 1,000 shares of Fairchild Camera and Instrument Corporation stock, 500 shares of American Research and Development Company stock, and 1,000 shares of Avon Products, Inc., stock with H. S. Kipnis & Co. (Pet. App. 18a–20a).

[2] Federal Reserve Board Regulation T (12 C.F.R. 220.8(d) and 220.4(c)(1)(ii)) requires a customer who wishes to sell "short" to open a general account and make a substantial margin deposit. In addition to restraining excessive use of credit in securities transactions (see Section 7 of the Securities Exchange Act of 1934, 15 U.S.C. 78g), margin deposits protect brokers who execute short sales against failures by their customers to deliver securities sold short (Tr. 16, 79–81, 207–208, 289).

[3] One of the orders, involving the sale of 1,000 shares of Fairchild Camera and Instrument Corporation stock, was executed by H. S. Kipnis & Co. by purchasing the shares for its own account (Pet. App. 9a).

"long" (Tr. 21, 26, 121–122, 138–143, 150–151, 206–209, 240–241, 278–279, 314–316).[4]

Contrary to respondent's expectations, the market prices of the securities continued to rise (Tr. 538–542). Unable to make covering purchases in time to meet his delivery obligations, respondent presented various excuses to the brokers but assured them that he owned the securities and was merely encountering difficulty in obtaining possession of them (Tr. 34, 83–84, 120, 145–146, 189–190, 255–256, 272, 344, 561). By September 1969, however, respondent realized that he could not meet his obligations and called a meeting of the representatives of the brokerage firms. He informed them that he did not own the securities in question and suggested that they "buy in" the number of shares needed to cover the sales at their own expense (Tr. 148–149, 554–558).[5] Each broker bought sufficient securities to fulfill its commitment to purchasers, but this process caused substantial losses to

[4] Sell orders placed on a national securities exchange must be marked either "long" or "short." 17 C.F.R. 240.10a–1(c). A broker may not mark a sell order "long" unless it "is informed that the seller owns the security ordered to be sold and, as soon as is possible without undue inconvenience or expense, will deliver the security * * *." 17 C.F.R. 240.10a–1(d).

[5] If a broker executes a sell order marked long and the seller fails to deliver the securities when due, the broker normally must "buy in" substitute securities for the purchasers. See 17 C.F.R. 240.10a–2(a). See also II L. Loss, *Securities Regulation* 1229–1235 (1961 ed.). This "buy-in" procedure serves as a form of insurance for investors who purchase securities through brokers.

the brokers (Tr. 31, 87–88, 147, 190, 279, 283, 320–321, 347–351, 554).[6]

2. The district court concluded that respondent had employed a scheme or artifice to defraud in the sale of securities, in violation of Section 17(a)(1) of the Securities Act of 1933, 15 U.S.C. 77q(a)(1), and that he had acted willfully and knowingly (Pet. App. 15a–20a). The district court found that respondent had represented that he was long in each security, "either by direct statement to that effect or by using words and phrases in placing the sell order which would be understood in the trade as a representation that Naftalin & Co. was 'long' in the stock." The district court also found that the brokers with which respondent dealt would not have accepted respondent's orders if he had told them the truth (*id.* at 17a). Respondent was convicted on all eight counts of the indictment.[7]

The court of appeals reversed (Pet. App. 1a–11a). Although the court was "convinced" that there was "no merit" to respondent's assertion that the evidence was insufficient to establish "fraud" (*id.* at 5a), it concluded that Section 17(a)(1) is not violated by

[6] See *Naftalin & Co.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166, 1170–1172 (8th Cir. 1972), for more detailed description of respondent's scheme. In that opinion the Eighth Circuit concluded that respondent had engaged in "obvious and calculated wrongdoing" (469 F.2d at 1172), resulting in aggregate losses to brokerage firms of more than $1,285,000.

[7] The court sentenced respondent to concurrent terms of five years' imprisonment, explaining that respondent had engaged in a "massive" scheme to defraud the brokerage firms (Sentencing Tr. 7).

"the species of fraud practiced against the defrauded brokers who were not purchasers * * *" (*ibid.*). Reasoning that the sole purpose of Section 17(a)(1) is to "protect investors from fraudulent practices in the sale of securities" (*id.* at 6a–7a), the court concluded that "the government must prove some impact of the scheme on an investor" (*id.* at 8a). Because only brokers suffered direct financial injury from respondent's fraud, and the "third party purchasers to whom the brokers sold were not deceived or defrauded in any way" (*id.* at 6a), the court held that respondent's scheme did not violate the statute.[8]

SUMMARY OF ARGUMENT

Section 17(a)(1) of the Securities Act of 1933 prohibits "any" scheme to defraud in a securities offer or sale. Nothing in the language or legislative history of the statute indicates that the identity of the parties defrauded is material. Because "[n]othing

[8] The court of appeals also reversed respondent's conviction on Count VI of the indictment, even though that count involved fraud on a broker who traded for his own account as an investor (*id.* at 9a–10a). The court reasoned that "the indictment did not allege that [the defrauded broker] was a purchaser and * * * [respondent] could not be tried on charges that were not made" (*id.* at 10a). Judge Ross dissented from the court's disposition of Count VI (*id.* at 11a). Although we believe that the court's reversal of respondent's conviction under Count VI was incorrect even assuming that Section 17(a)(1) applies only to investor fraud (see *Hamling* v. *United States*, 418 U.S. 87, 117 (1974)), we have not raised that question for review. See Pet. 5 n.4. Of course, if this Court accepts our construction of Section 17(a)(1) the convictions on all eight counts should be reinstated.

on the face of the statute suggests a congressional intent to limit its coverage" (*United States* v. *Culbert*, 435 U.S. 371, 373 (1978)), the statute should not be restricted to frauds involving investor injury.

Investor protection was an essential purpose of the provision, but it was not the only purpose. The protection of business and the economy as a whole from the harmful effects of securities fraud also was important. As the Senate Committee Report pointed out, "[t]he purpose of this bill is to protect the investing public and honest business." S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933). Because Congress intended to protect business as well as investors under the Act, lack of injury to a specific investor is no ground for denying application of Section 17(a)(1) where fraud is proven.

At all events, respondent's scheme was aimed at investors, even though the investors' losses were shifted to brokers by the brokers' obligation to "buy in" securities. If the brokers had refused or been unable to honor their buy-in obligations, the losses here involved would have been suffered by the investors themselves.

Finally, it is evident that the absence of effective sanctions against fraud practiced on financial institutions such as brokers, investment advisers, transfer agents, and trust companies would result in decreased deterrence of fraud. Fraud poses a threat to the integrity of the national securities markets that are served by such institutions and thus affects investors. An increase in the number of frauds practiced on financial institutions would decrease their efficiency and increase their cost of doing business, resulting in higher expenses for investors served by such institutions. Thus, investors are harmed by fraudulent schemes practiced on the financial institutions that serve them.

ARGUMENT

FRAUDULENT MISREPRESENTATIONS MADE BY A PERSON IN THE OFFER OR SALE OF A SECURITY VIOLATE SECTION 17(a)(1) OF THE SECURITIES ACT OF 1933 WHETHER OR NOT AN INVESTOR IS INJURED DIRECTLY

The decision of the court of appeals, which limits the coverage of Section 17(a)(1) to fraudulent practices that cause injury to "investors," effectively bars application of the statute to prohibit frauds practiced on financial intermediaries such as brokers, transfer agents, clearing agencies, and investment advisers. But the statute explicitly prohibits "any" fraudulent practice "in the offer or sale of any securities." That broad prohibition extends to the species of fraud practiced by respondent. Respondent's fraudulent scheme occurred at the very heart of the securities markets, causing injury to securities professionals whose services are essential to the process of trading. In the absence of legislative history showing that the statute should not be applied at face value, or that institutional intermediaries in the securities markets should be denied protection, there is no warrant for curtailing its coverage. As we dem-

onstrate below, Congress intended the broad language that it employed in Section 17(a)(1) to be taken literally.

A. SECTION 17(a)(1) UNAMBIGUOUSLY PROHIBITS FRAUD OF ANY KIND IN THE OFFER OR SALE OF SECURITIES

1. The language of the statute applies to respondent's fraud

" 'The starting point in every case involving construction of a statute is the language itself.' " *Teamsters* v. *Daniel,* No. 77-753 (Jan. 16, 1979), slip op. 6; *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 197 (1976); *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 472 (1977); *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 756 (1975) (Powell, J., concurring). Section 17(a)(1) of the Act prohibits "any person in the offer or sale of any securities * * * directly or indirectly * * * to employ any device, scheme, or artifice to defraud." The definitional section of the statute (Section 2(3), 15 U.S.C. 77b(3)), in turn, defines the terms "sale" and "offer" in the broadest possible manner:

> The term "sale" * * * shall include every contract of sale or disposition of a security or interest in a security, for value. The term * * * "offer" shall include every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value.

The breadth of the term "sale" is shown by the provision that "contracts" to sell or dispose of securities are "sales." See *SEC* v. *National Securities, Inc.,* 393 U.S. 453, 467 & n.8 (1969); *Vine* v. *Beneficial Finance Co.,* 374 F.2d 627, 634 (2d Cir.), cert. denied,

389 U.S. 970 (1967); *Roe* v. *United States,* 316 F.2d 617, 620 (5th Cir. 1963). The term "offer" is broader still, extending to "every attempt" to dispose of a security. See I L. Loss, *Securities Regulation* 512 & n. 163 (1961 ed.) ("[T]he definition of 'offer' is obviously much broader than the common law concept").

The statute proscribes fraud by "any person," without regard to his role in the securities transaction. The statute does not state or even suggest that the proscription depends on the identity or role of the victim of the fraud. Nor, finally, is there a limitation on the method used to commit the wrong, since the prohibition extends to "any" scheme to defraud, whether it operates "directly" or "indirectly." It is hard to imagine how Congress could have written a more sweeping statute. So long as jurisdictional means are used, Section 17(a)(1) prohibits, without limitation, all fraudulent schemes practiced by anyone against anyone in an offer or sale of securities. The rule is simple to understand: there are no exceptions.[9]

Respondent both offered and sold securities. Respondent placed sell orders with various brokers; the brokers executed the orders, resulting in contracts of sale within the statutory definition. Respondent also made "attempts" to "dispose of" securities, and thus made "offers" within the meaning of the statute, when he directed the brokers to initiate sale transactions. Respondent's fraud took place "in" these offers and

[9] Section 17(c), 15 U.S.C. 77q(c), specifically provides that the exemptions in Section 3 of the Act, 15 U.S.C. 77c, are inapplicable to Section 17.

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sales.[10] The fraud set the transactions in motion and was the basis for the transactions. Respondent deceived the brokers about the subject matter of the sales that they executed, and the brokers were injured as a direct consequence of that deception. Moreover, even though the brokers were not intended to be the "purchasers" of the securities in question, they had a direct financial stake in them. The brokers' "buy in" obligation (see note 5, *supra*) required them to insure the delivery of the securities. The brokers thus inevitably took part of the risk of the selling process, and here respondent's fraud caused real loss. Section 17(a)(1) thus applies to respondent's fraud.

Here, as in *United States* v. *Culbert,* 435 U.S. 371, 373 (1978), "[n]othing on the face of the statute suggests a congressional intent to limit its coverage." Just as it was improper to restrict the scope of the Hobbs Act "by reference to an undefined category of conduct termed 'racketeering'" (*id.* at 380), so it was improper for the court of appeals to restrict the scope of Section 17(a)(1) to "the species of fraud" practiced on "investors" (Pet. App. 5a). Here, as in *Culbert,* the broad words of the statute "do not lend themselves to restrictive interpretation" (435 U.S. at 373). Section 17(a)(1) covers "any" fraud in the offer and sale process, not just "the species of fraud" that injures investors. See *United States* v. *Gilliland,* 312 U.S. 86, 93 (1941).

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[10] But for respondent's fraud, the sales would not have taken place. As the district court found, the brokers would not have executed respondent's orders if they had been told the truth about his "short" position (Pet. App. 17a).

Because the statute is unambiguously applicable to respondent's scheme,[11] there is no reason to apply rules of construction, such as the "rule of lenity" (see Pet. App. 8a–9a), that are designed to resolve ambiguity. As this Court observed in *United States* v. *Culbert, supra,* 435 U.S. at 379 "[i]t is true that 'ambiguity concerning the ambit of criminal statutes should be resolved in favor of lenity.' * * * But here Congress has conveyed its purpose clearly, and we decline to manufacture ambiguity where none exists." See also *Scarborough* v. *United States,* 431 U.S. 563, 577 (1977); *Barrett* v. *United States,* 423 U.S. 212, 217, 218 (1976); *SEC* v. *C. M. Joiner Leasing Corp.,* 320 U.S. 344, 354–355 (1943).

2. A comparison with other securities statutes establishes the scope of Section 17(a)(1)

Our contention that Section 17(a)(1) applies to "any" fraud in the offer or sale of securities, and not just "the species of fraud" practiced on investors, is fortified by comparing Section 17(a)(1) with the other anti-fraud provisions of the Securities Act of 1933. Congress understood the difference between general anti-fraud provisions and more limited

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[11] Respondent can hardly claim that the statute provided inadequate notice. As both courts below concluded, respondent's short selling scheme was a calculated fraud. Moreover, the decisions of this Court had established, long before respondent undertook his scheme to defraud, that the securities laws were to be interpreted broadly to effectuate their remedial purposes. See, *e.g.*, *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

ones dealing with fraud practiced on securities purchasers. The 1933 Act contains both kinds of rules. See *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 734; cf. *Barrett* v. *United States, supra,* 423 U.S. at 217. For example, Section 17(a)(3) of the Act, 15 U.S.C. 77q(a)(3), prohibits fraudulent practices that operate "as a fraud or deceit upon the purchaser." Cf. Sections 11 and 12 of the Act, 15 U.S.C. 77k and 77*l*, which authorize the filing of civil damages actions by defrauded investors only. Section 17(a)(1), in contrast, is a "general proscription against fraudulent and deceptive practices" (*SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 197–198 (1963)), which places no limitation on the class of defrauded parties.

Of course, respondent's fraudulent scheme may have violated provisions of the federal securities laws in addition to Section 17(a)(1). It is likely that respondent's scheme also violated Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), which this Court has described as "parallel" to Section 17(a). *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 733. Section 10(b) prohibits any person to employ any manipulative or deceptive device or contrivance "in connection with the purchase or sale of any security," in contravention of the Securities and Exchange Commission's rules and regulations. Respondent violated Section 10(b) because he employed fraud in connection with the placement of sell orders, which resulted in the execution of contracts that are tantamount to sales (see pages 11–12, *infra*). But the applicability of Section 10(b) does not render Section 17(a)(1) inapplicable.[12] See generally, *Edwards* v. *United States,* 312 U.S. 473, 483–484 (1941); *SEC* v. *National Securities Inc, supra,* 393 U.S. at 468. Indeed, in one important respect, Section 17(a)(1) is broader than Section 10(b) and relates more precisely to the fraudulent scheme involved in the present case. "The wording of § 10(b) directed at fraud 'in connection with the purchase or sale' of securities stands in contrast with the parallel antifraud provision of the 1933 Act, § 17(a) * * * reaching fraud 'in the offer or sale' of securities." *Blue Chip Stamps* v. *Manor Drug Stores, supra,* 421 U.S. at 733–734. Thus, in order to reach fraud in respondent's "offer" of securities, as well as fraud in the "sale" of securities, the prosecution appropriately relied on Section 17(a)(1) rather than Section 10(b).[13]

[12] The fact that Section 10(b) applies to frauds that are "in connection with" a purchase or sale, while Section 17(a) applies to frauds that are "in" a sale or offer, is not significant here. Respondent's fraud was integral to the process of offering and selling securities. It was "in," not external to, that process. Moreover, although the expression "in connection with" may suggest a somewhat looser relationship to the securities trading process than the term "in," that difference should not be overstated. This Court has used the two expressions interchangeably. See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6, 12 (1971). So did Congress when Section 17(a) was enacted. See H.R. Rep. No. 85, 73d Cong., 1st Sess. 6 (1933); H.R. Conf. Rep. No. 152, 73d Cong., 1st Sess. 26 (1933).

[13] The indictment charged respondent with fraud in the "offer and sale" of securities (A. 15–21).

In sum, both the language of the statute, which prohibits "any" fraud in the offer or sale of a security, and its place in the statutory scheme, demonstrate the court of appeals' error. As we now discuss, moreover, the legislative history underscores the breadth of the statute.

B. CONGRESS INTENDED TO PROHIBIT ALL FRAUDULENT PRACTICES IN SECURITIES OFFERS OR SALES IN ORDER TO PROTECT BUSINESS AND THE NATIONAL ECONOMY AS WELL AS INVESTORS

The Eighth Circuit's limitation of Section 17(a)(1) to frauds injuring "investors" is not supported by the legislative history of the Securities Act of 1933. To be sure, Congress was deeply concerned with investor protection. Its prohibition of fraudulent practices had broader purposes, however. The 1933 Act grew out of Congress' conclusion that securities frauds were injurious to business and the general economy as a whole.

1. The Securities Act of 1933 was part of Congress' response to the stock market crash of 1929. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 194–195 (1976).[14] In addition to requiring full disclosure of information concerning public offerings of securities for the protection of investors, the Act was intended "to promote ethical standards of honesty and fair dealing." *Id.* at 195. A principal purpose of the 1933 Act, like

[14] The history of the Act is recounted in I Loss, *Securities Regulation, supra,* at 119–128. For the personal account of one of its draftsmen, see Landis, *The Legislative History of the Securities Act of 1933,* 28 Geo. Wash. L. Rev. 29 (1959).

the other federal securities laws, was to assure that "the highest ethical standards prevail in every facet of the securities industry." *SEC* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 186–187. See also *United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837, 849 (1975).

Congress' intent to enact a comprehensive anti-fraud provision is evident throughout its deliberations on the Securities Act of 1933. Cf. *SEC* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 191. Section 17, the general anti-fraud provision, began as Section 13 of S. 875, 73d Cong., 1st Sess. (1933), and H.R. 4314, 73d Cong., 1st Sess. (1933), parallel bills introduced in the House and the Senate. In relevant part, Section 13 provided that

> * * * it shall be unlawful for any person, firm, corporation, or other entity in any interstate sale, promotion, negotiation, advertisement, or distribution of any securities defined by this Act willfully to employ any device, scheme, or artifice to defraud or to obtain money or property by means of any false pretense, representation or promise, or to engage in any transaction, practice, or course of business relating to the interstate purchase or sale of any securities which operates or would operate as a fraud upon the purchaser. * * *

As redrafted by Professors Frankfurter and Landis, and resubmitted in the House of Representatives (see Landis, *The Legislative History of The Securities Act*

of 1933, 28 Geo. Wash. L. Rev. 29, 31–41 (1959)), the general anti-fraud provision read as follows:

> It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of, or omission to state, a material fact, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud upon the purchaser.

See H.R. 5480, 73d Cong., 1st Sess. Section 16(a) (1933). Among other changes made before passage of the bill, Congress expanded the antifraud provision to include all fraudulent schemes, whether practiced "directly or indirectly." See H.R. Conf. Rep. No. 152, 73d Cong., 1st Sess. 12 (1933).

The comprehensive language of Section 17(a)(1), as finally enacted, which forbids "any device, scheme, or artifice to defraud," was apparently based on the general mail fraud statute, 25 Stat. 873 (now codified in 18 U.S.C. 1341), which forbids any person using the mails "to devise any scheme or artifice to defraud." See 1A. Bromberg, *Securities Law Fraud—SEC Rule 10b-5* 21 (1975 ed.); III Loss, Securities *Regulation, supra,* at 1421–1423. The sponsors of the bill made it clear, however, that Section 17(a) was in-

tended to expand existing law and to prohibit all forms of fraud in securities transactions. See, *e.g.*, remarks of Senator Fletcher, 77 Cong. Rec. 2983, 2984 (1933): "We are trying to cover instances where there seem to be loopholes and means of escape, and to apply the measure particularly to the matter of dealing in securities * * * The bill rather strengthens and broadens the authority to proceed in such instances." See also Douglas and Bates, *The Federal Securities Act of 1933,* 43 Yale L. J. 171, 181–182 (1933); III Loss, *Securities Regulation, supra,* at 1423–1424, 1428–1430, 1439; H.R. Rep. No. 1542, 83d Cong., 2d Sess. 26 (1954).

In emphasizing the need to eliminate fraudulent practices, the sponsors of the legislation referred repeatedly to business injuries resulting from securities fraud. See, *e.g.,* remarks of Senator Fletcher, 77 Cong. Rec. 2983 (1933); remarks of Senator Norbeck, *id.* at 3232 ("We all hope for an early business recovery, but that is impossible without a return to plain, old-fashioned business honesty"); remarks of Rep. Kelly, *id.* at 2925 ("I am for this securities bill * * * it will give protection to honest and legitimate industry which has been, in many instances, made the victim of greedy and ruthless investment bankers"); remarks of Rep. Chapman, *id.* at 2935 ("This legislation is designed to protect not only the investing public but at the same time to protect honest corporate business. * * * It will stimulate industry; it will accelerate the wheels of commerce"); remarks of Rep. Keller, *id.* at 2944, 2945 ("When the downright dis-

honesty * * * and conspiracy to cheat and defraud * * * are for a certainty done away with, we shall find the very conditions which business security demands * * *. These racketeers have broken down the capitalistic system * * * practically wrecked business * * *"). There is no suggestion in the legislative debates that Congress intended to protect investors but not financial intermediaries. To the contrary, investor protection and the security of the market process were seen as parts of the same goal.

The Senate committee report on the bill that ultimately became the Securities Act of 1933 stated clearly that "[t]he purpose of this bill is to protect the investing public and honest business." S. Rep. No. 47, 73d Cong. 1st Sess. 1 (1933). Business had been injured in various ways by dishonest securities transactions. Businesses seeking to attract capital through honest disclosures could not compete with other businesses employing misleading representations. *Ibid.* "Equally significant" as the loss suffered by individual investors was the "wastage that * * * irresponsible selling of securities * * * caused to industry." H.R. Rep. No. 85, 73d Cong., 1st Sess. 2 (1933). The House Report also pointed out, in its catalogue of abuses to be remedied, that "[e]ven dealers through the exertion of high-pressure tactics" had been "forced to take allotments of securities of an essentially unsound character." *Id.* at 3. See also S. Rep. No. 1036, 83d Cong., 2d Sess. 4 (1954).

In sum, Congress believed that proscription of all types of fraud in securities transactions would protect

would not be appropriate to limit

business and the general economy in addition to protecting investors. In light of these broad purposes, it Section 17(a)(1) to frauds causing injury to investors. The expansive language of Section 17(a)(1) was not inadvertent. It was prompted by an equally expansive remedial purpose. See *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 151 (1972); *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 195.

2. The cases cited by the Eighth Circuit do not support its conclusion that the sole objective of the Act was investor protection. The only decision of this Court that the Eighth Circuit cites is *Ernst & Ernst* v. *Hochfelder*, *supra* (see Pet. App. 7a). But *Ernst & Ernst* points out that, in addition to protecting investors, Congress intended to "promote ethical standards of honesty and fair dealing." 425 U.S. at 195. The lower court decisions cited by the Eighth Circuit (Pet. App. 7a) merely state the obvious: that investor protection was a purpose of the Act. They do not suggest that the only purpose was to protect investors.[15]

[15] The case cited by the Eighth Circuit to establish that "the government must show some impact of the scheme on the investor" (*United States* v. *Ashdown*, 509 F. 2d 793, 799 (5th Cir. 1975)), does not stand for such a proposition. *Ashdown* affirmed a criminal conviction under Section 17(a), rejecting the defendant's contention that the government must prove "reliance" by investors on the misrepresentations. In discussing the jurisdictional requirement of the statute, *Ashdown* stated in dictum that the government must show use of the mails having some effect on an investor. The discussion in *Ashdown* dealt only with the question whether the use of the mails there involved was sufficiently important to the fraudulent scheme to satisfy the jurisdictional means requirement, an issue not presented here.

The lower court authority contrary to the Eighth Circuit's interpretation is substantial. *United States* v. *Brown,* 555 F.2d 336 (2d Cir. 1977), sustained a conviction under Section 17(a) where the defendant had defrauded a transfer agent[18] by submitting counterfeit stock certificates and obtaining genuine certificates in exchange. The Second Circuit squarely rejected the "investor injury" limitation adopted by the court below (555 F.2d at 338-339):

> While this court has noted that the primary purpose of the 1933 Act was to protect investors * * * appellant has not cited and we have not found any case holding that this was its sole purpose and that unless the ultimate purchaser of securities is injured or defrauded the criminal provisions of [Section 17(a)] are not violated. The language of that section * * * broadly condemns the employment of 'any device, scheme, or artifice to defraud' * * *. [T]here is no doubt that Congress in the broad language employed in [Section 17(a)] was intent upon protecting the integrity of the marketplace in which securities are traded.

Accord, *United States* v. *Gentile,* 530 F.2d 461, 467 (2d Cir.), cert. denied, 426 U.S. 936 (1976). See also *A.T. Brod & Co.* v. *Perlow,* 375 F.2d 393, 396-397 (2d Cir. 1967), holding that fraudulent practices

[18] A transfer agent registers the transfer of securities on behalf of an issuer and exchanges or converts existing securities. See Section 3(a)(25) of the Securities Exchange Act of 1934, 15 U.S.C. 78c(a)(25).

injuring brokers violate Section 10(b) of the 1934 Act and pointing out that Section 10(b) (like Section 17(a)) does not "speak[] in terms of limiting the nature of the violation to one involving fraud of 'investors.'"

C. PROTECTION OF FINANCIAL INTERMEDIARIES CONTRIBUTES TO INVESTOR PROTECTION

Although, as we have shown above, investor protection is not the only purpose of the Securities Act of 1933, it certainly is an important purpose. Consequently, although the lack of direct injury to an investor cannot provide a basis for refusing to apply Section 17(a)(1), the presence of such injury in this case would be an additional reason for applying Section 17(a)(1). As we demonstrate below, the protection of financial intermediaries contributes to the goal of investor protection.

1. Respondent's scheme was aimed at investors to the same extent that it was aimed at brokers. Respondent misrepresented his short position to brokers, and through them to investors, when he caused orders marked "long" to be executed on the New York Stock Exchange. Respondent caused brokers to sell phantom shares to real investors. The shares could not be delivered. Brokers suffered the direct loss here only because federal regulations required the brokers to "buy in" shares to deliver to the purchasers, thus covering for the delivery obligation that respondent fraudulently assumed. The "buy in" rule transferred the loss from the investors (who otherwise would have been deprived of the ownership of the appreciated

shares) to the brokers, who had to buy shares at the appreciated price and deliver them at the contracted for, lower price. This served as a form of insurance for the investors. If the brokers had been financially unable to buy in the shares, the investors themselves would have suffered the loss. Entitled to receive shares at one price under the purchase contract, they would have been forced to buy substitute shares in the market at a higher price."[17]

It is not logical to conclude that the "species of fraud" practiced by respondent was not harmful to investors simply because the investors happened to be protected by the brokers' "buy in" obligation.[18] As the Second Circut pointed out in *United States* v. *Brown, supra,* 555 F.2d at 339, "[o]ne might as well argue that if Brown stole [some person's] fully insured automobile, he was never the victim of a larceny." The court continued (*ibid.*):

[17] At the time of respondent's fraudulent scheme, there were certain exceptions to the "buy-in" duty based on the good faith and diligence of the brokers. See 17 C.F.R. 240.10a-2(b); Rule 440B of the New York Stock Exchange, 2 CCH New York Stock Exchange Guide ¶2440B.17-19. The brokers in this case were not entitled to relief under these rules.

[18] Section 17(a)(1) prohibits the scheme to defraud itself. The fact that the scheme may fail to harm an intended victim—perhaps because of the victim's diligence—would be no defense. "[I]t is clear that the establishment of a 'scheme * * * to defraud' under Clause (1) is not dependent upon proof that any victim suffered actual loss." III Loss, *Securities Regulation, supra*, at 1439-1440 (collecting cases). See *Farrell* v. *United States*, 321 F.2d 409, 419 (9th Cir. 1963) (it is "well settled" in the lower courts "that in a prosecution [under Section 17(a)(1)] the government is not required to prove that anyone was defrauded or that any investor sustained loss"). See also *SEC* v. *Capital Gains Research Bureau, Inc., supra*, 375 U.S. at 195.

> The fact that the Uniform Commercial Code might ultimately shift the monetary loss from Smith and the ultimate investors hardly serves to exculpate Brown and his group of fellow thieves, counterfeiters and forgers from criminal responsibility. This was not of course the garden variety of security fraud—its long planned execution * * * constituted a massive assault upon innocent investors and brokerage houses and their normal business procedures which we cannot construe the statute to countenance.

What is more, when the 1933 Act was passed there was not yet a "buy in" requirement under federal regulations. At that time the loss caused by the "species" of fraud practiced by respondent could have fallen directly on purchasers. It is unlikely that the promulgation of the "buy in" requirement some years after the enactment of the 1933 Act could restrict the scope of Section 17.

2. The lack of sanctions against fraudulent schemes practiced on financial institutions harms investors in other ways. Losses suffered by brokers increase their cost of doing business; in the long run, investors must cover at least part of this cost by paying higher prices for brokerage and other services. There are many such financial institutions: broker-dealers,[19] transfer agents and clearing agencies,[20] investment

[19] Six thousand two hundred seventy-seven broker-dealers were registered with the Commission as of December, 1978.

[20] Eighteen hundred seventy-four transfer agents were registered with the Commission as of December, 1978.

advisers,[21] and commercial bank trust departments. The services performed by these institutions are central to the operation of the national securities markets and essential to investors welfare.[22] See *United States* v. *Brown, supra,* 555 F.2d at 339. In the end, fraud renders all of these services more costly or more risky, to the detriment of all investors.

It is significant, too, that fraudulent short selling schemes can disrupt the national securities markets, causing effects detrimental to all investors. Section 7 of the Securities Exchange Act of 1934, 15 U.S.C. 78 g,, directs the Federal Reserve Board to adopt margin requirements for the purpose of preventing excessive speculation in securities purchases and sales. The Board has promulgated regulations that limit speculation by requiring short sellers to make substantial cash deposits. See note 2, *supra.*[23] Section 10 (a) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(a), authorizes the Securities and Exchange Commission to adopt rules governing short selling. The Commission has promulgated regulations (17 C.F.R. 240.10a-1) that limit short selling in declining mar-

[21] Five thousand three hundred eighty-five investment advisers were registered with the Commission as of December, 1978.

[22] Brokers, transfer agents, clearing agencies, and investment advisers are subject to pervasive regulation under the federal securities laws. See 15 U.S.C. 78*o et seq.*, 15 U.S.C. 78q-1 *et seq.*, and 15 U.S.C. 80b-1 *et seq.* Congress has not demonstrated an intent to impose the burdens of the securities laws on these financial institutions without conferring the protections of the securities laws.

[23] See also II Loss, *Securities Regulation, supra,* at 1239-1256; SEC *Report of Special Study of Securities Markets,* H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 4, 9 (1963).

kets. By concealing the fact that he was selling short, respondent evaded both the requirement that he make a cash deposit and the requirement that he sell short only during appropriate market conditions. As the Eighth Circuit observed in its earlier opinion in *Naftalin & Co.* v. *Merrill Lynch, Pierce, Fenner & Smith, supra,* 469 F.2d at 1181, "the artificial stimulation of the market resulting from Naftalin's short-selling scheme [is] in direct conflict with Section 7's objectives." See also *United States* v. *Peltz,* 433 F.2d 48, 53 (2d Cir. 1970): "Short selling without compliance with the margin and short sale price rules can have a materially larger adverse effect on the public than a seller's hoodwinking a buyer into an unfortunate purchase of a few hundred shares." Accord, *A. T. Brod & Co.* v. *Perlow, supra,* 375 F.2d at 397; SEC Report of Special Study of Securities Markets, H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 2, 292-293 (1963); II Loss, *Securities Regulation, supra,* at 1229 (" 'in a declining market certain types of short sales are seriously destructive of stability.' ").

Respondent's scheme to engage in substantial short selling transactions, escaping (by fraud) the restrictions prescribed by Congress, the Federal Reserve Board, and the Securities and Exchange Commission to protect the integrity of the national securities markets, thus posed a threat to those markets and to the investors participating in them. Even though investor injury is not prerequisite to a finding of liability under Section 17(a)(1), there was harm to the investing public here. That injury is an additional ground for applying Section 17(a)(1) to respondent's scheme.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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OCTOBER TERM, 1978

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UNITED STATES OF AMERICA,

Petitioner,

vs.

NEIL T. NAFTALIN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

QUESTION PRESENTED

Whether Section 17(a)(1) of the Securities Act of 1933 is sufficiently broad in scope, as a criminal statute, to encompass a misrepresentation by a customer to a stockbroker in employing its services as agent to effect an undisclosed short sale of securities through the facilities of the New York Stock Exchange, where no offer or sale is made to the broker, and no purchaser of securities is either deceived or damaged.

STATUTE INVOLVED

Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), provides:

> It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

STATEMENT OF THE CASE

The Government's Statement reflects a basic lack of understanding of securities transactions effected through the facilities of the New York Stock Exchange ("NYSE" or "Exchange"), as well as undisputed facts central to the eight short-sale transactions which form the subject matter of the indictment. Because the resulting confusion pervades the Government's argument concerning the nature of the transactions and their alleged impact on investors, a fundamental illustration of both Exchange transactions and the transactions in question is required.

The Typical Exchange Transaction

The transactions in question occurred in July and August 1969. At that time, as at present, the typical transaction in securities listed on the Exchange involved a four-link chain: the selling customer ("Seller"); his broker; the purchasing customer's broker; and the purchasing customer ("Purchaser").

To illustrate: When a Seller, let's say in Minneapolis, decides to sell a listed security, say 100 shares of IBM, he calls his stockbroker, acting as his agent, and instructs the broker to sell the 100 shares, typically at the prevailing market price. His broker, say the Minneapolis office of Merrill Lynch, Pierce, Fenner & Smith, Inc. ("Merrill Lynch"), transmits the sell order to the floor of the Exchange in New York, where it is delivered to the specialist in IBM stock.

Perhaps simultaneously, somewhere else in the country, a Purchaser decides to buy 100 shares of IBM. The Purchaser, say in Baltimore, calls his broker, acting as his agent, and instructs him to buy 100 shares of IBM at the prevailing market price. The Purchaser's broker, say the Baltimore office of Paine Webber, Jackson & Curtis ("Paine Webber"), transmits the buy order to the floor of the Exchange, where it is delivered to the specialist in IBM stock.

The specialist now has in hand both sell and buy orders for 100 shares of IBM "at the market". He matches up the order tickets, at the prevailing price, say $100 per share, thereby effecting a transaction between Seller and Purchaser.

The respective brokers are immediately advised of the

trade and price, and are identified to each other. Merrill Lynch learns that its customer, the Seller, has sold 100 shares of IBM at $100 per share, or $10,000 [less Merrill Lynch's agency commission], to an unidentified purchaser represented by Paine Webber. Paine Webber learns that its customer, the Purchaser, has purchased 100 shares of IBM for $10,000 [plus Paine Webber's agency commission] from an unidentified seller represented by Merrill Lynch.

The day on which the foregoing transpires is the trade date ("Trade Date"). By industry rule and practice, the transaction is closed five business days, or seven calendar days, later, on the settlement date ("Settlement Date").[1]

On the Settlement Date, either physically, by bookkeeping entry or in a clearinghouse transaction, Merrill Lynch [Minneapolis] delivers 100 shares of IBM to Paine Webber [Baltimore] and receives $10,000 from it.

In the meantime, between Trade Date and Settlement Date, Merrill Lynch and Paine Webber send written confirmations of the transaction to their respective customers. Merrill Lynch's confirmation statement to the Seller, *i.e.*, its contract with its customer, advises the Seller that he sold 100 shares of IBM at $100 per share on the Trade Date, with Merrill Lynch acting as his agent, and instructs him that his certificate for 100 shares of IBM must be delivered to Merrill Lynch [if Merrill Lynch does not already have it] by the Settlement Date. Upon delivery of the certificate, and only upon delivery, the Seller receives payment of $10,000 [less Merrill Lynch's commission].

[1]Until 1946, the industry imposed a two-business-day settlement requirement on all contracts. The settlement date was thereafter successively changed to three business days in August 1946; to four business days in March 1952; and to five business days in February 1968, all to provide additional time for the settlement process. See NYSE Rule 64.

Paine Webber's confirmation statement to the Purchaser, *i.e.*, its contract with its customer, advises the Purchaser that he bought 100 shares of IBM at $100 per share on the Trade Date, and instructs him that he must pay $10,000 [plus Paine Webber's commission] for the stock no later than the Settlement Date.

What happens if the Seller does not deliver a certificate for 100 shares of IBM to Merrill Lynch on the Settlement Date? *Merrill Lynch "borrows" 100 shares of IBM, either from its own inventory, from the "inventory" of its margin-account customers, or from another broker,*[2] *and "loans" it to the Seller, for his account, in order to complete the transaction.* In essence, Merrill Lynch thereby extends credit to the Seller equal to the value of the stock loaned for his account.[3]

Thus, on Settlement Date, Merrill Lynch delivers 100 borrowed shares of IBM to Paine Webber, and receives $10,000 in exchange. Merrill Lynch does not deliver the $10,000 to the Seller, however. It holds the funds for payment against delivery of a certificate for 100 shares of IBM.

One more point on Merrill Lynch's rights vis-á-vis the Seller on Settlement Date. If the Seller does not deliver a certificate for 100 shares on the Settlement Date, it is in breach of contract, and Merrill Lynch has the right to purchase the stock in the market for the Seller's account, and to recover damages for the difference, if any, between the price at which the Seller sold [$100 per share] and the

[2]In exchange, the lending broker obtains the use of funds equal to the value of the stock borrowed.

[3]Section 7 of the Securities Exchange Act of 1934, 15 U.S.C. § 78g, governs the extension of credit by brokers to their customers in securities transactions. Section 7(c) of the Act spawned Regulation T, 12 C.F.R. § 220, a comprehensive statement by the Federal Reserve Board of the circumstances under which credit may be extended.

price which Merrill Lynch pays to replace the undelivered shares, say $105 per share. The latter replacement transaction is a customer "buy-in", *i.e.*, a purchase for the Seller's account.[4]

It is plain that the Government understands neither the general function of such a buy-in, nor the facts concerning the buy-ins effected in connection with the transactions covered in the indictment. [*E.g.*, G.Br. 5, 12, 23-25.]

The Transactions in Question

With one exception,[5] the sale transactions covered in the indictment were entered on the NYSE on their Trade Dates, and closed on their Settlement Dates, in the manner just described.

The Respondent was the principal of Naftalin & Co., Inc. ("Naftalin"), which was registered as a broker-dealer under the securities laws, but which had ceased doing business with the public in 1963. In 1969, Naftalin was trading for its own account, at the Respondent's direction, through brokers who were either members of the NYSE, or enjoyed correspondent relationships with Exchange members. The brokers through whom the transactions were effected knew that Naftalin did not have a public business; knew the Respondent as a sophisticated investor running

[4]Customer buy-ins are required by regulation under certain circumstances, but they do not serve as a vehicle for concluding the delivery of stock to the Purchaser or his broker on Settlement Date. See SEC Rule 10a-2, 17 C.F.R. § 240.10a-2. In addition, the SEC has recently imposed a mandatory 10-business-day post-Settlement Date customer buy-in requirement on all Exchange transactions, if the broker has not obtained possession of the stock from its customer "for any reason whatsoever". SEC Rule 15c3-(3)(m), 17 C.F.R. § 240.15c3-3(m).

[5]See n. 13, *infra*.

a one-man operation; and, in each instance, knew him through a prior course of dealing as a regular customer, albeit a large and theretofore profitable one. [Pet.App. 3a; *e.g.*, Tr. 37-9, 48-9, R.Ex. A, Tr. 177-9, R.Exs. G-H, Tr. 158, 302, R.Ex. K, Tr. 193, 331-3.]

The Respondent was engaged in a "short selling" scheme, essentially as described by the lower courts [Pet. App. 2a-5a, 16a-20a], and we intend no further debate here on the sufficiency of the evidence to support the finding of what the court of appeals described as a "species of fraud practiced against the defrauded brokers, who were not purchasers. . . ." [Pet. App. 5a.]

In seven separate instances in July and August 1969, the Respondent instructed five brokers[6] with whom Naftalin maintained cash accounts to sell stocks listed on the Exchange for the account of Naftalin, which Naftalin did not own when the instructions were given.[7] He did so in a manner which would be understood by the brokers who took the orders as a representation that Naftalin owned the stocks it was selling.[8] Likewise, the Respondent en-

[6]Merrill Lynch; Paine Webber; Piper, Jaffray & Hopwood, Inc.; Dain, Kalman & Quail, Inc.; and H. S. Kipnis & Co.

[7]Under Regulation T, 12 C.F.R. § 220.4(c)(1)(ii), a broker may effect "bona fide cash transactions" for a customer in a Special Cash Account, in which the broker may "sell any security for . . . any customer, provided the security is held in the account or the [broker] is informed that the customer or his principal owns the security and the . . . sale is in reliance upon an agreement accepted by the [broker] in good faith that the security is to be promptly deposited in the account."

[8]Under Regulation T, 12 C.F.R. § 220.3, a broker may effect a sale of stock which the customer does not own, *i.e.*, a "short sale", only in a General Account, commonly referred to as a "margin account", if the broker obtains a deposit of cash or securities having a collateral value equal to a specified percentage of the sale price. The deposit of cash or securities is received as collateral for a "loan" of the securities sold short, to complete the transaction on Settlement Date, subject to later purchase and delivery of the securities by the customer to repay the "loan" from the broker.

tered the sell orders in the expectation that (a) the market price of the stock sold would decline, (b) the brokers would not require delivery of the stock certificates for a considerable period of time, (c) the same stocks could be purchased from other brokers thereafter at a lower price, and certificates obtained promptly, and (d) the stocks could be delivered to the selling brokers in exchange for the original sales proceeds, with a resulting profit.

Each of the transactions occurred in essentially the same fashion as the following example, which describes the short sale charged in Count II of the indictment.

On August 5, 1969, the Respondent called the registered representative assigned to Naftalin's account in Paine Webber's Minneapolis office and said "Sell long 1,000 Burroughs at the market for Naftalin & Company". [Tr. 25.] The representative wrote up an order ticket, the order was transmitted to the floor of the Exchange in New York and a sale was promptly confirmed.[9] [Tr. 25-7, 45-6.] Of the 1,000 shares sold, 900 shares were sold at $135.50 per share and 100 were sold at $135.25 per share.[10] [Tr. 26, G.Ex. 6.]

Following the Trade Date, Paine Webber sent confirmations of the transaction to Naftalin, confirming the sale and prices, and indicating that delivery of 1,000 shares of Burroughs was due on August 12, the Settlement Date, against payment of the net sale proceeds ($134,699, after payment of commissions of $525 to Paine Webber and applicable taxes.). [Tr. 29-30; G.Exs. 2, 3.]

[9]The record does not reflect the identity of the broker on the other side of this, or any other, transaction charged in the indictment, nor the identity of the Purchasers for whom such brokers acted.

[10]Stocks listed on the Exchange are sold in "round lots" of 100 shares. A sale of 1,000 shares "at the market" may thus involve sales of one or more round lots at one or more prices. In that event, the Seller's broker prepares separate confirmation statements for shares sold at different prices.

On the Settlement Date, Paine Webber had not received a certificate for 1,000 Burroughs from Naftalin. As was its custom, it did not call the Respondent to inquire about the certificate. Instead, Paine Webber borrowed 1,000 shares of Burroughs from another broker; delivered the borrowed shares to the broker on the other side of the transaction, for Naftalin's account; and received the sale proceeds of $135,225. [Tr. 86, 90-3.] It did not deliver the sale proceeds to Naftalin; it held them to await delivery of the stock, which never arrived. [Tr. 47-8; 90.]

In summary, as of the Settlement Date, the transaction effected on the Exchange, as between the broker for the Seller and the broker for the Purchaser, was completed. The stock sold, 1,000 Burroughs, was in the custody of the Purchaser's broker; the sale proceeds were in the possession of Paine Webber, to be paid to Naftalin against delivery of stock, 1,000 Burroughs, to replace the stock borrowed for Naftalin's account.

Thereafter, toward the end of August, and again in late September or early October 1969, a representative of Paine Webber called the Respondent to inquire about the 1,000 shares of Burroughs, and another transaction.[11] and was advised that the Respondent "was having difficulties obtaining the securities from a third party and would deliver them when he was able to." [Tr. 83-4.]

Ultimately, the Respondent's short-selling scheme collapsed, by reason of a precipitous rise in the market price of the stocks sold short, and Naftalin's resulting financial

[11]The July 22, 1969 sale of 500 shares of American Research and Development charged in Count I of the indictment.

inability to make covering purchases through other brokers.

On October 27, 1969, the Respondent called a meeting of the brokers involved and advised them of what had happened.[12] On the same day, Paine Webber executed a customer buy-in of 1,000 Burroughs for Naftalin's account, at $161 per share, for a total of $161,551 (including Paine Webber's agency commission of $551 on the purchase). [Tr. 87, 109-10; G.Ex. 7.] On the Settlement Date of that transaction, November 3, Paine Webber charged Naftalin's account with the difference between the buy-in price and the original sale proceeds, *i.e.,* approximately $26,800, representing Paine Webber's loss on the buy-in. [Tr. 87-8, 95.]

The stock received by Paine Webber on its customer buy-in was, and could only have been, used to replace the stock "borrowed" from another broker on August 12, and loaned to Naftalin's account, to conclude the earlier transaction. It was not used, as the Government says, to fulfill Paine Webber's "commitment to purchasers". [G.Br. 5.]

Each of the other short sale transactions charged in the indictment, except one,[13] bears the essential character-

[12]The Government misstates the date of the meeting as being in September 1969. [G.Br. 5.]

[13]Count VI of the indictment involves an undisclosed short sale of 1,000 shares of Fairchild Camera by Naftalin, as principal, to H. S. Kipnis & Co. ("Kipnis"), as principal, on August 28, 1969, which was not executed through the facilities of the Exchange. [Tr. 143, G.Ex. 12, Def. Ex. C, Tr. 163.] Over-the-counter transactions in securities listed on the Exchange are known as "third market" trades. [Tr. 135.] Kipnis, which was not a member of the NYSE, was a third market maker in listed stocks, and traded with Naftalin from time to time as such. [Tr. 144.] On agency transactions for Naftalin, Kipnis employed the services of a correspondent broker in New York which was an Exchange member. [Tr. 139, 182.] Although the court of appeals struggled with

istics of the transaction just described. The Respondent gave sell orders to the brokers, as Naftalin's agents, on the respective Trade Dates, misrepresenting by statement or implication Naftalin's ownership of the securities sold;[14] the orders were executed on the Exchange;[15] the brokers sent confirmation statements to Naftalin, as their customer;[16] the brokers concluded the transactions with the brokers for the respective purchasers on the respective Settlement Dates by borrowing the stocks from other sources and loaning them to Naftalin's account;[17] the brokers received the proceeds of each sale, but did not deliver them to Naftalin, holding them instead against delivery of stock

Count VI, ultimately dismissing it for its failure to allege that Kipnis was a "purchaser" of the stock, in our view an additional basis for dismissal is that Kipnis was in no way deceived by the short sale. Short selling in the third market was not regulated in 1969, and was a common occurrence among sophisticated traders, trading as principals, without disclosure. [Tr. 158-60, 164, 362-3.] In such trading, the purchaser is not concerned with whether the seller is "long" or "short" at the time of sale, but only that the seller has the wherewithal to obtain and deliver the stock, which Naftalin then had. In that regard, the Respondent made a "mark to market" payment of $93,000 to Kipnis on September 4, 1969, to cover the difference between the sale prices of Naftalin's open transactions with Kipnis and the market increases which had occurred on those stocks to that date. [Tr. 146-7, 153-4, R.Ex. B.] In any event, the Government has not raised the dismissal of Count VI for review. [G.Br. 7, n. 8.]

[14]Tr. 19, 55-8, 67-9 [Count I]; Tr. 237-9, 242-4 [Count III]; Tr. 313-4, 330-3 [Count IV]; Tr. 120-3, 127-30 [Count V]; Tr. 152-3, 357-60, 364-66, 371-2 [Counts VII and VIII].

[15]Tr. 21, G.Ex. 5, Tr. 45-6 [Count I]; Tr. 239-41, G.Ex. 19, Tr. 249-50, 278-9 [Count III]; Tr. 314-7, G.Ex. 25, Tr. 325 [Count IV]; Tr. 121, G.Ex. 9, Tr. 122, 125, 130 [Count V]; Tr. 138-9, 150, 358-60, G.Exs. 29-30, Tr. 365-9 [Counts VII and VIII].

[16]Tr. 30, G.Ex. 4 [Count I]; Tr. 258, G.Ex. 20 [Count III]; Tr. 318, G.Exs. 26-27 [Count IV]; Tr. 123-4, G.Exs. 10-11 [Count V]; Tr. 142-4, G.Exs. 13-14 [Counts VII and VIII].

[17]Tr. 46-7, 85-6, 90-3 [Count I]; Tr. 250-2, 267, 300-1 [Count III]; Tr. 322-5, 335-41 [Count IV]; Tr. 217-8 [Count V]; Tr. 182-6 [Counts VII and VIII].

certificates which never arrived;[18] the Respondent made post-sale misrepresentations concerning delivery;[19] and the brokers executed customer buy-ins in late October 1969, for Naftalin's account, in order to return the borrowed stocks, charging the purchase prices to Naftalin's account, and sustaining losses thereby.[20]

Subsequent Procedural History

Two days after the Respondent's disclosure of his short-selling activities to the brokers on October 27, 1969, he made a detailed disclosure of the entire scheme to the Securities Exchange Commission ("SEC") at a meeting with SEC officials in Washington, D.C. The eight transactions ultimately charged in the indictment immediately became the subject matter of litigation, at the Government's instance, or with its active participation, as follows:

1. On November 4, 1969, the SEC commenced a civil action against Naftalin and the Respondent, and obtained a preliminary injunction, with their consent, restraining them from violations of Section 10(b) of the 1934 Act, and Section 17(a) of the 1933 Act, predicated on the short-selling activities. Following the appointment of a receiver for Naftalin in December 1969, the injunctive action remained essentially dormant until its conclusion by the entry of a permanent injunction, also by consent, on August 29, 1972.[21]

2. On February 10 and 18, 1970, separate involuntary petitions in bankruptcy were filed against Naftalin by six brokers through whom Naftalin had made undisclosed short sales, including Merrill Lynch, Paine Webber, Piper Jaffray and Kipnis, in which the brokers asserted claims based upon losses sustained in executing their customer buy-ins.[22] The SEC [Chicago] assisted counsel for the brokers in the preparation of the petitions, and monitored the proceedings closely for more than two years. Then, in March 1972, the SEC [Washington] participated as *amicus curiae* in an appeal by the brokers from the district court's order limiting their contract damage claims.[23] It urged the appellate court to either severely limit or invalidate the brokers' claims on the grounds that the brokers had unlawfully extended credit to Naftalin in violation of Section 7 (c) of the 1934 Act, and Regulation T, by executing sell orders in cash accounts knowing that prior sale transactions had not settled promptly, and by failing to execute customer buy-ins shortly after the settlement dates of the transactions.[24]

3. In the meantime, on September 30, 1971, the SEC [Chicago] commenced an administrative proceeding against Naftalin and the Respondent under Section 15 of

[18] Tr. 47, 90 [Count I]; Tr. 251, 267, 301 [Count III]; Tr. 319-20 [Count IV]; Tr. 221 [Count V]; Tr. 162 [Counts VII and VIII].

[19] Tr. 34 [Count I]; Tr. 255-6, 259-63, 272 [Count III]; Tr. 344 [Count IV]; Tr. 189-90 [Count V]; Tr. 146 [Counts VII and VIII].

[20] Tr. 87-9, 108-10, G.Ex. 8 [Count I]; Tr. 281-2, G.Exs. 21-22, Tr. 306 [Count III]; Tr. 320-1, G.Ex. 28, Tr. 345-50 [Count IV] [Dain, Kalman realized a profit of $3,000 on the buy-in of the short sale charged in Count IV, which it offset against a loss of $20,000 on the buy-in of a short sale not covered in the indictment]; Tr. 204-6, G.Ex. 15, Tr. 218, 225, 227-9, G.Exs. 16-17 [Count V]; Tr. 167-74, R.Exs. D-F [Counts VII and VIII].

[21] *SEC v. Naftalin & Co., Inc., et al.*, 4-69 Civ. 385 (D. Minn. 1969).

[22] *In re Naftalin & Co., Inc.*, 4-70 Bky. 137, 170 (D. Minn. 1970); 315 F.Supp. 463 (D. Minn. 1970); 333 F.Supp. 136 (D. Minn. 1971).

[23] *Naftalin & Co., Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166 (8th Cir. 1972).

[24] *Id.*, SEC Br., *amicus curiae*, at 12-22 (March 29, 1972).

the 1934 Act, seeking to revoke Naftalin's broker-dealer registration, and to bar the Respondent from the securities industry for life, for violations of Section 10(b) of the 1934 Act and Section 17(a) of the 1933 Act.[25] At the hearing in November 1972, the SEC sought to establish the violations on the basis of the eight short-sale transactions ultimately alleged in the indictment, through the same witnesses who ultimately testified at the criminal trial. On June 19, 1973, the administrative proceeding concluded with a final decision revoking Naftalin's registration and barring the Respondent "from association with any broker or dealer". [R.Exs. Z-7, Z-8.]

The present indictment was returned against the Respondent on April 11, 1974, charging violations of Section 17(a) of the 1933 Act, but omitting reference to Section 10(b) of the 1934 Act.[26] To the best of our knowledge, the indictment represented the first prosecution of short-selling activities under Section 17(a) in the 41-year history of the statute.

On August 8, 1975, the district court dismissed the indictment on the ground that the Government's four and one-half year delay in presenting the matter to the grand jury presented an "outrageous case" of pre-indictment delay, denying the Respondent due process of law. On appeal by the Government, the indictment was reinstated by the

[25] *In re Naftalin & Co., Inc. and Neil T. Naftalin*, SEC File No. 3-3277 (September 30, 1971).

[26] The basis for the Government's decision to prosecute under Section 17(a) must be left to conjecture. The maximum penalty for violations of Section 17(a) was and is a five-year prison term. 15 U.S.C. § 77x. The maximum penalty for violations of Section 10(b) of the 1934 Act was, until June 4, 1975, a two-year prison term, when an amendment increasing the maximum to a five-year term became effective. 15 U.S.C. § 78ff.

Eighth Circuit. This Court denied the Respondent's petition for a writ of certiorari.[27]

The district court subsequently denied a motion by the Respondent to dismiss the indictment on the ground that the permanent bar from the securities industry imposed upon him by the SEC in the administrative proceeding as a penalty for the same short sale transactions, placed him in double jeopardy. The indictment was thereafter tried to the court in December 1976, the Respondent having waived a jury trial. On February 1, 1977, the Respondent was convicted on all eight counts. On March 18, 1977, the district court denied the Respondent's renewed motion for dismissal on the ground of double jeopardy, and sentenced the Respondent to concurrent five-year prison terms on each count.[28]

On June 13, 1978, the Eighth Circuit reversed the conviction and dismissed the indictment on the ground that Section 17(a) of the 1933 Act does not reach the "species of fraud" in question.[29] It noted that "as between [Respondent] and the brokers, there was no offer or sale of securities", and that the "purchasers to whom the brokers sold were not deceived or defrauded in any way." [Pet. App. 6a] It held that the purpose of Section 17(a) of the 1933 Act "was to protect investors from fraudulent practices in the sale of securities" and that "the government

[27] *United States v. Naftalin*, 534 F.2d 770 (8th Cir. 1976), *cert. denied*, 429 U.S. 827 (1977).

[28] The Respondent surrendered to the U.S. Marshal on the same day, and was incarcerated in the federal prison at Sandstone, Minnesota. He was released on August 12, 1977, on $500 bond, pending appeal. [G.App. 10.]

[29] *United States v. Naftalin*, 579 F.2d 444 (8th Cir. 1978); Pet. App. 1a-11a. As a result, the court did not reach the Respondent's double jeopardy claim.

must prove some impact of the scheme on an investor." [Pet.App. 6a-7a, 8a.]

This Court granted certiorari on December 11, 1978.

SUMMARY OF ARGUMENT

Section 17(a)(1) of the Securities Act of 1933 prohibits only fraud "in the offer or sale" of a security. The statute is inapplicable by its terms to the Respondent's deception of his brokers in engaging their services to effect sales transactions for Naftalin's account on the New York Stock Exchange, in that no offer or sale of stock to the brokers was involved.

Properly construed, each of subparagraphs (1), (2) and (3) of Section 17(a) requires the employment of a fraudulent or deceptive practice upon an offeree or purchaser of securities. The statute is inapplicable by its terms to the Respondent's deception of his brokers, who were neither.

Section 17(a) of the 1933 Act was intended by Congress to protect investors, principally in connection with the initial issuance of securities in public offerings, as the first step toward the ultimate objective of comprehensive federal regulation of securities transactions. Congress understood that the legislation did not address the full spectrum of abuses in securities trading, including those relating to extensions of credit and excessive short-selling. It left the regulation of the latter abuses to the Securities Exchange Act of 1934.

The 1934 Act, particularly in Sections 7 and 10, contains provisions which directly bear upon the Respondent's short-selling activities, and are designed to protect brokers from the fraudulent practices of their customers.

The Government elected to prosecute the Respondent under an inappropriate criminal statute, with full awareness of the appropriate statutory and regulatory weapons in its arsenal. The dismissal of the indictment should therefore be affirmed.

ARGUMENT

MISREPRESENTATIONS BY A CUSTOMER TO ITS BROKER IN CAUSING THE BROKER TO EFFECT THE SHORT SALE OF A SECURITY ON THE EXCHANGE DO NOT VIOLATE SECTION 17(a) OF THE SECURITIES ACT OF 1933, WHERE NO OFFER OR SALE IS MADE TO THE BROKER, AND NO PURCHASER OF SECURITIES IS EITHER DECEIVED OR DAMAGED.

The court of appeals correctly recognized that the Respondent's course of conduct with the brokers is not the "species" of misconduct proscribed, or intended to be proscribed, by Section 17(a). The analysis of Exchange transactions and the transactions involved in the indictment in the preceding pages suggests the reasons.

1. Misrepresentations by a customer to its broker do not constitute fraud "in the offer or sale" of a security.

The statute prohibits fraud "in the offer or sale" of securities. The word "in" is "a function word to indicate inclusion, location or position within limits." Webster's New Collegiate Dictionary (1977). It denotes conduct within the confines of an offer to sell, or a sale itself, and thereby proscribes only conduct directed at the recipient of an offer or the purchaser of securities. The word "in" is to be con-

trasted with the phrase "in connection with", found in Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), which connotes a far broader range of activities surrounding a sale transaction.

The definitions of the terms "offer" and "sale" in Section 2(3) of the 1933 Act, 15 U.S.C. § 77b(3), lend no greater expanse to the word "in". The definition of "offer" as an "attempt . . . to dispose of . . . a security for value" does not alter the statutory requirement that the fraud occur "in" the attempted disposition, *i.e.*, in conduct directed to a prospective investor. Likewise, the definition of "sale" as a "contract of sale or disposition of security . . . for value" does not alter the requirement that the fraud occur "in" the disposition for value, i.e., in conduct directed at the investor.[30]

"In order to sustain a conviction the Government must show some impact of the scheme on the investor. . . ." *United States v. Schaefer*, 299 F.2d 625, 629 (7th Cir.), *cert. denied*, 370 U.S. 917 (1962). "[W]hat must be shown is that the scheme had an impact on the investor. . . ." *United States v. Ashdown*, 509 F.2d 793, 799 (5th Cir.), *cert. denied*, 423 U.S. 829 (1975).

As the court of appeals observed, the scheme employed by the Respondent, directed at the brokers, involved no offers to sell or sales to them.[31] The Respondent employed the brokers as his agents to sell securities listed on

[30]The definition of "sale" also includes the disposition of an "interest in a security", which accounts for *United States v. Gentile*, 530 F.2d 461 (2d Cir.), *cert. denied*, 462 U.S. 936 (1976), cited by the Government. [G.Br. 22.]

[31]The district court found only fraud in the "sale" of securities. [Pet.App. 20a] The court of appeals found fraud in neither "offer" nor "sale". [Pet.App. 6a] "Offer" and "sale", of course, are distinct acts. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 733 n. 5 (1975).

the Exchange, and he did so by misleading statements and omissions. The sales were made and closed with the purchasers without incident, however, and no purchaser was deceived or injured in any way. Therefore, no fraud occurred "in the offer or sale" of the securities, within the language of the statute.

2. Misrepresentations by a customer to its broker do not constitute fraud upon an offeree or purchaser.

The limitation imposed by the word "in", as the introductory word in the phrase "in the offer or sale of any securities", is supported by reviewing Section 17(a) as a whole. The statute provides:

> It shall be unlawful for any person in the offer or sale of any securities . . . directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon *the purchaser*. (Emphasis added.]

As is implicit from the introductory phrase "in the offer or sale", the words "the purchaser" in subparagraph (3) should be read into subparagraphs (1) and (2), to reflect the clear intention of the drafters of the legislation. Thus, the statute should be construed to read as follows:

> It shall be unlawful for any person *in the offer or sale* of any securities . . . directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud [*an offeree or purchaser*], or
>
> (2) to obtain money or property [*from an offeree or purchaser*] by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon [*an offeree or*] *the purchaser*. [Emphasis and bracketed material added.]

If the numbered subparagraphs of the statute had not been numbered, or if the words "the purchaser" had been separated from subparagraph (3) and set off at the left margin, with minor grammatical corrections, as they should have been, the intended meaning of the statute would have been manifest.[32]

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[32]See, for example, Section 12 of the 1933 Act, 15 U.S.C. § 77*l*, which provides:

> Any person who—
>
> (1) offers or sells a security in violation of section 5, or
>
> (2) offers or sells a security . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,
>
> *shall be liable to the person purchasing such security from* him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security. [Emphasis added.]

The italicized phrase clearly modifies both subparagraphs (1) and (2). See also SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, p. 31, *infra*.

As the Government notes [G.Br. 17], the original form of the statute in the legislative process read as follows:

> [I]t shall be unlawful for any person, firm, corporation, or other entity in any interstate sale, promotion, negotiation, advertisement, or distribution of any securities defined by this Act willfully to employ any device, scheme, or artifice to defraud or to obtain money or property by means of any false pretense, representation or promise, or to engage in any transaction, practice, or course of business relating to the interstate purchase or sale of any securities which operates or would operate as a fraud upon the purchaser.[33]

Again, the use of the phrase "in any . . . sale" was plainly meant to proscribe conduct directed toward, and impacting, purchasers, and the words "the purchaser" were intended to modify the preceding clauses relating to schemes to defraud and obtaining money by false pretenses. The restructuring of Section 17(a) by separating its constituent clauses and numbering them should not be permitted to alter the intended meaning of the statute as a whole, particularly as a criminal statute, simply because the restructurers were inexact in their assigned task.

"[P]unctuation is not decisive of the construction of a statute." *Costanzo v. Tillinghast*, 287 U.S. 341, 344 (1932). In *Porto Rico Railway, Light and Power Co. v. Diez*, 253 U.S. 345, 348 (1919), this Court said:

> When several words are followed by a clause which is applicable as much to the first and other words as to the last, the natural construction of the language demands that the clause be read as applicable to all.

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[33]Section 13 of S.875, 73d Cong., 1st Sess. (1933) and H.R. 4314, 73d Cong., 1st Sess. (1933).

See also United States v. Bass, 404 U.S. 336, 339 n. 6 (1971).

In view of the legislative history of the statute, discussed below, "it is reasonable to conclude that Congress intended to bring the [purchaser] limitation to apply to . . ." Section 17(a)(1). *Federal Maritime Commission v. Seatrain Lines, Inc.,* 411 U.S. 726, 734 (1973).

The court of appeals and other lower courts which have viewed the statute critically are therefore clearly correct in holding that the Government must prove "some impact of the scheme on an investor" for a conviction under Section 17(a)(1). *United States v. Ashdown,* 509 F.2d 793, 799 (5th Cir.), *cert. denied,* 423 U.S. 829 (1975); *United States v. Schaefer,* 299 F.2d 625, 629-30 (7th Cir.), *cert. denied,* 370 U.S. 917 (1962).[34] As the court of appeals likewise held, the present record contains no evidence that any investor was injured or deceived in any way by the Respondent's misrepresentations to the brokers.

3. The legislative history of the 1933 Act reflects a Congressional objective to protect investors from fraudulent practices in the sale of securities.

"[C]ourts will construe the details of an act in conformity with its dominating general purpose." *SEC v. C. M. Joiner Leasing Corp.,* 320 U.S. 344, 350 (1943). The "dominating general purpose" of the 1933 Act, as the court of appeals noted, was the protection of purchasers of securities. [Pet.App. 6a-8a.]

[34]The contrary language in *United States v. Brown,* 555 F.2d 336, 338-9 (2d Cir. 1977), cited by the Government [G.Br. 22], should be viewed in light of the court's conclusion that an investor was in fact defrauded, and that the particular scheme there involved constituted a "massive assault on innocent investors".

Both the 1933 Act and the Securities Act of 1934 followed the market crash of 1929, and an intensive investigation by the Senate Banking and Currency Committee.[35] The 1933 Act was preoccupied with the regulation of public offerings of securities. The 1934 Act was directed to abuses in the trading of securities in the "aftermarket".

The 1933 Act represented "but one step", and was enacted for the purpose of "protecting investors and depositors." It was to be "followed by legislation relating to better supervision of the purchase and sale of all property dealt in on exchanges. . . ." President's Message to Congress (March 29, 1933).[36] The Act was drafted so as "not [to] affect transactions beyond the need of public protection in order to prevent recurrences of demonstrated abuses." H.R. Rep. No. 85, 73d Cong., 1st Sess. 9 (1933).

[35]Landis, *The Legislative History of the Securities Act of 1933,* 28 Geo. Wash. L. Rev. 29, 30 (1959).

[36]*See also* 77 Cong.Rec. 2948 (1933) (remarks of Rep. Mott); 77 Cong. Rec. 2915 (1944) (remarks of Rep. Sabath). In fact, criticism was leveled against the 1933 legislation for its failure to regulate trading abuses:

> I am in hearty accord with this measure. It will be a forward stride and will protect the American public and the buyers of securities. However, it will not reach evils from which the American people have suffered in recent years and from which they are still suffering.
>
> The manipulation of securities after they have been issued embraces and constitutes a greater evil than those arising from the original issue of securities. I refer to the vicious and criminal practices indulged in by stockbrokers but which are possible under the rules and regulations of the New York Stock Exchange. These should be dealt with by Congress.
>
> One of the worst evils is that of short selling.

77 Cong. Rec. 2941 (1933) (remarks of Rep. Smith).

> I had hoped that we would enact a bill at this time that would forever prevent dishonest listings and transactions. But unfortunatelv the committee came to the conclusion that at this time they could not do it all in one bill. . . .
>
> But I renew the notice that I served on the House three and a half years ago that I will not desist until these invidious and thoroughly reprehensible practices of short selling, "selling against the box" and floor trading are abolished.

77 Cong. Rec. 2915 (1933) (remarks of Rep. Sabath).

The "demonstrated abuses", in turn, overwhelmingly related to the need for adequate and accurate public disclosure in the initial public offering of securities.

The 1933 Act, in short, was designed to protect purchasers of securities. Every debate, every report and every hearing with respect to the Act is so permeated by that fundamental legislative aim that the recitation of each supporting reference would serve no real purpose.[37]

The method chosen for implementing the objective was to compel the disclosure of all material information to securities purchasers, through a general registration requirement for public offerings, rather than attempting to prohibit the distribution of worthless securities. In essence, Congress preferred to "protect . . . the public by informing the investor". House Hearings at 10 (remarks of Huston Thompson, drafter of the original House bill). "[T]he truth must be told to the purchaser." *Id.* at 58 (remarks of Mr. Pettengill).

To bolster the objective, Congress sought to impose civil and criminal liability on those who failed to meet the required standards of disclosure.

The civil and criminal liability sections were intended as adjuncts to the general policy of disclosure, as is evident from their language. Sections 11 and 12, the civil lia-

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[37]*E.g.*, "The operation of the bill looks rather to the interest of the purchaser." Hearing on H.R. 4314. Committee on Interstate and Foreign Commerce, 73d Cong., 1st Sess. (1933) (hereinafter, the "House Hearings") at 44. "We have got to keep in mind all the time the people who purchase the stocks and securities and who have lost everything." House Hearings at 124. "We will prevent damage to purchasers." House Hearings at 212. "[T]he purpose of the bill under consideration is to protect the investing public . . . ." 77 Cong. Rec. 2930 (1933) (remarks of Rep. Wolverton). "It is a bill intended for the protection of the American public from the purchase of worthless and fraudulent securities." 77 Cong. Rec. 2934 (1933) (remarks of Rep. Chapman).

bility sections, expressly limit relief to purchasers.[38] Section 17, the criminal liability section, was viewed by Congress as the criminal counterpart of the civil liability sections.[39] "Under the bill in case of fraud or misrepresentation in the sale of securities, the remedies are as follows: (1) The purchaser may rescind the transaction and sue for a return of his money . . . (4) Those guilty of the fraud may be prosecuted criminally. . . ." S Rep. No. 47, 73d Cong., 1st Sess. (1933)[40]

The legislative history of the 1933 Act does contain isolated and oblique references to the protection of "honest business", as the Government says. [G.Br. 19-20.] The overwhelming conscious purpose of the Act, however, was

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[38]Section 11, 15 U.S.C. § 77k, creates civil liability to purchasers for misleading registration statements. It provides in part: "In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omited to state a material fact required to be stated therein or necessary to make statements therein not misleading, *any person acquiring such security* . . . may, either at law or in equity, in any court of competent jurisdiction, sue . . . [underwriters and others named in, or contributing to, registration statements]." [Emphasis added]. Section 12 is quoted in n. 32, *supra*.

[39]Section 17 was derived in substantial part from New York's "Martin Act". Herlands, *Criminal Law Aspects of the Securities Act of 1933*, 67 U.S. L. Rev. 562, 571 (1933). Liability under the Martin Act arises only for fraud on a purchaser. *People v. Wachtell*, 181 Misc. 1010, 47 N.Y.S.2d 945, 946 (1943); *People v. F. H. Smith Co.*, 230 App. Div. 268, 243 N.Y.S. 446, 449 (1930).

[40]The major distinction perceived between the civil and criminal liability sections related to the fact that imposition of criminal liability would sometimes require greater culpability. "This bill makes absolutely responsible the issuer, the underwriter, and the dealer. It makes him responsible civilly if he sells stocks upon misrepresentation; it makes him guilty of fraud and criminally liable if he sells it with misrepresentation and *fraudulent intent*." 77 Cong. Rec. 2919 (1933) (remarks of Rep. Rayburn). [Emphasis added.] "They are not only liable civilly for an untrue statement of a material fact and for the omission to state a material fact, but they are also criminally liable when they fail to do that which was required of them and which was done with the purpose to defraud the *purchaser of the security*." 77 Cong. Rec. 2924 (1933) (remarks of Rep. Bulwinkle). [Emphasis added.]

the protection of securities purchasers. The Act was designed to proscribe conduct by broker-dealers, as underwriters, and not, as the Government suggests, to protect them from deceptive practices by their customers.[41]

In summary, the 1933 Act was conceived by Congress to compel disclosure of material information in public securities offerings, in order to protect purchasers of securities. Section 17(a)(1) should be construed and limited accordingly in this case.

4. Securities trading in general, and fraudulent short-selling and illegal extensions of credit on securities in particular, are governed by the Securities Exchange Act of 1934.

The 1934 Act represented the "second step" in the federal regulation of securities, regulation of the trading of outstanding securities.[42] *Blue Chip Stamps v. Manor Drug Stores,* 421 U.S. 723, 728, 752 (1975). In his message to Congress, President Roosevelt stated that notwithstanding the "first step" embodied in the 1933 Act, "there re-

[41] "The flotation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise." H. R. Rep. No. 85, 73d Cong., 1st Sess. 4 (1933). "The average investor has little, if any, technical knowledge concerning the value of securities. He relies largely upon the reputation of the management of the corporation, upon the representations of the issuer, the underwriter, and the technical advisers of the corporation. The inevitable result is that unscrupulous issuers and underwriters, acting under the protective wing of interstate commerce, have preyed ruthlessly upon the uninformed and the credulous." 77 Cong. Rec. 2935 (1933) (remarks of Rep. Chapman).

[42] "Mr. Chairman, I am sure that everyone sees the very close intimate relationship between the Securities Act and this stock-exchange bill. The Securities Act deals primarily with original distribution of securities, while the stock exchange act deals with trading and outstanding securities." 78 Cong. Rec. 8107 (1934) (remarks of Rep. Cox).

mains the fact . . . that outside the field of legitimate investment naked speculation has been far too alluring and far too easy for those who could and for those who could not afford to gamble." President's Message to Congress (February 9, 1934).

Two significant concerns during the congressional deliberations were abuses arising from short sales[43] and from extensions of credit by brokers to customers,[44] neither of which subjects had been dealt with in the 1933 legislation.

Thereafter, as adopted, the 1934 Act provided for the regulation of short-selling and other extensions of credit on securities by the Federal Reserve Board [Section 7], with the regulation of the mechanics of short-selling on national securities exchanges left to the SEC [Section 10 (a)]. To complement these measures, Congress enacted Section 10(b) as a "catch-all clause to prevent manipulative devices." Hearings on H. R. 7852 and H. R. 8720, Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 115 (1934). *See also Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 202, 203 (1976).

[43] Hearings on H. R. 7852 and H. R. 8720, Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. 25, 34-40, 44, 46-50, 55, 71, 86, 115, 135, 193-6, 208, 258, 294-5, 305, 337, 441-2, 502-4, 559, 633, 749, 780-2, 826-31 (1934).

[44] One purpose of the 1934 Act was "to discourge use of credit and financing in excessive speculation in securities." Hearings on H. R. 7852 and H. R. 8720, Committee on Interstate and Foreign Commerce, 73d Cong., 2d Sess. (1934). "The first idea is control of the amount of credit that gets into the market." *Id.* at 85. "This bill is founded upon the theory that in some way an injury is inflicted on our business and financial life by the too easy flow of credit into the stock market." 78 Cong. Rec. 8387 (1934) (remarks of Senator Buckley). "The supplying of credit by a broker to a customer for the purpose of carrying speculative or investment securities creates a relationship which is fundamentally wrong . . ." 78 Cong. Rec. 8386 (1934) (remarks of Senator Buckley).

It is those provisions which directly bear upon the Respondent's short-selling activities, not Section 17(a) of the 1933 Act.

Section 7(c) of the 1934 Act, 15 U.S.C. § 78g(c), provides:

> It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit or arrange for the extension or maintenace of credit to or for any customer—
>
> (1) On any security . . . in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe. . . .

Regulation T, 12 C.F.R. § 220, was promulgated by the Federal Reserve Board in accordance with the statute.

At the time of the occurrence of the events in this case, the onus of compliance with Section 7(c) and Regulation T rested solely with brokers who extended credit, and not customers who received it.[45]

Shortly thereafter, in 1970, Section 7(f), 15 U.S.C. § 78 g(f), was added to the 1934 Act. It provides in part:

> It is unlawful for any . . . person . . . to obtain, receive or enjoy . . . extension of credit from any lender . . . for the purpose of . . . purchasing or carrying . . . securities . . . if, under this section or rules

[45]*Pearlstein v. Scudder & German*, 429 F.2d 1136, 1141 (2d Cir. 1970), *cert. denied*, 401 U.S. 1013 (1971) ("[T]he federally imposed margin requirements forbid a broker to extend undue credit but do not forbid customers from accepting such credit"); *Naftalin & Co., Inc. v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 469 F.2d 1166 (8th Cir. 1972); *Moscarelli v. Stamm*, 288 F.Supp. 453, 458 (E.D. N.Y. 1968) ("No duties or restrictions were imposed by the Act and the regulation upon the investor-customer.").

> and regulations prescribed thereunder, the loan or other credit transaction is prohibited. . . .

Regulation X, 12 C.F.R. § 224.2, was promulgated by the Federal Reserve Board pursuant to Section 7(f). It provides in part:

> A borrower shall not obtain any purpose credit . . . unless he does so in compliance with the following conditions:
>
> * * *
>
> (2) credit obtained from a broker/dealer shall conform to the provisions of [Regulation T]. . . .

Section 7(f) and Regulations T and X were not available to the Government in the prosecution of the Respondent's 1969 short-selling activities.

As of the present time, however, both brokers and their customers are expressly prohibited from making unmargined short sales by Section 7 and Regulations T and X, under criminal penalty for willful violations. 15 U.S.C. § 78ff.

Section 10 of the 1934 Act *was* available to the Government in the prosecution of the Respondent. Both of its substantive provisions were clearly and unambiguously applicable to short-selling schemes, without the necessity of proving any impact on investors. *United States v. Peltz*, 433 F.2d 48 (2d Cir. 1970).[46]

Section 10(a) of the 1934 Act, 15 U.S.C. § 78j(a), provides:

> It shall be unlawful for *any person*, directly or indirectly, by the use of any means or instrumentality

[46]*Cf.*, *A. T. Brod & Co. v. Perlow*, 375 F.2d 393, 396-7 (2d Cir. 1967).

of interstate commerce or of the mails, or of any facility of any national securities exchange—

> (a) *to effect a short sale* . . . of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe *as necessary or appropriate in the public interest* or for the protection of investors. [Emphasis added.]

As it existed in 1969, Rule 10a-1, 17 C.F.R. § 240.-10a-1, promulgated by the SEC under Section 10(a), read as follows:

> No person shall for his own account or for the account of any other person, effect on a national securities exchange a short sale of any security (1) below the price at which the last sale thereof, regular way, was effected on such exchange, or (2) at such price unless such price is above the next preceding different price at which a sale of such security, regular way, was effected on such exchange.[47]

Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) *To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange* or any security not so registered, *any manipulative or deceptive device or contrivance* in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate *in the public interest* or for the protection of investors. [Emphasis added.]

[47]Rule 10a-1 is known alternatively in the securities industry as the "up tick" or "down tick" rule. It is designed, as the Government notes [G.Br. 26], to prohibit short-selling in a declining market.

Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated by the SEC under Section 10(b), provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (1) To employ any device, scheme or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

5. The unavailability of Section 17(a) as an enforcement tool against undisclosed short-selling does not threaten brokers, given the protection afforded by Sections 7 and 10 of the 1934 Act.

The composite of the statutes and rules quoted above is of dual significance here.

First, they provide a complete response to the Government's argument that the "protection of financial inter-

mediaries" requires a broad construction of Section 17(a) of the 1933 Act. [G.Br. 23-7.] All such persons, including brokers, are now fully protected against short selling schemes of the "species" employed by the Respondent under Sections 7(c), 10(a) and 10(b) of the 1934 Act, Regulations T and X of the Federal Reserve Board, and SEC Rules 10a and 10b-5, respectively.

Second, the Government was fully conversant with Sections 10(a) and (b) and the regulations when this prosecution was commenced, and it was fully aware that both provisions had been employed successfully in the past to prosecute short-selling violations by customers. The SEC has alleged violations of Section 10(b) by the Respondent in the same transactions ultimately charged in the indictment, as the basis for both the injunction action commenced in November 1969 and the administrative proceeding commenced in September 1971.

At the same time, the Government knew, as the court of appeals said, that in the entire history of Section 17 (a) of the 1933 Act there existed "no case in which [the statute] has been used to prosecute a defendant for fraud in the sale of securities perpetrated upon an agent-broker, where no investor has been deceived or defrauded as a result of the fraud." [Pet.App. 9a.] The Government's "need" for Section 17(a) as an enforcement tool for undisclosed short-selling, and its conscious decision to pursue Section 17(a) in this case, should be assessed accordingly.

Paraphrasing *International Brotherhood of Teamsters v. Daniel,* 99 S.Ct. 790, 802 (1979), "not only is the extension of [Section 17(a)] by the [Government] unsupported by the language and history of the [1933 Act], but in light of [the 1934 Act] it serves no general purpose."

6. Any ambiguity in Section 17(a) should be resolved in favor of lenity.

Under the circumstances, the Government should not be heard to urge the liberal construction of a criminal statute.

As this Court said in *Foremost-McKesson, Inc. v. Provident Securities Co.,* 423 U.S. 232, 244 (1976), the Government's approach is "unsatisfactory in its focus on situations that [the statute] may not reach rather than on the language and purpose of the . . . provision itself." Even in a civil context, this Court has not been inclined to read a securities provision "more broadly than its language and the statutory scheme reasonably permit." *SEC v. Sloan,* 98 S.Ct. 1702, 1711 (1978). In a criminal context, the statute must be strictly construed, and the Respondent may not "be subjected to a penalty unless the words of the statute plainly impose it." *United States v. Campos-Serrano,* 404 U.S. 293, 297 (1971).

In short, "ambiguity concerning the ambit of a criminal statute should be resolved in favor of lenity." *Rewis v. United States,* 401 U.S. 808, 812 (1971).

CONCLUSION

The writ of certiorari issued to the court of appeals should be dismissed as having been improvidently granted. In the alternative, the judgment of the court of appeals should be affirmed.

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FOR ARGUMENT

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No. 78-561

In the Supreme Court of the United States

OCTOBER TERM, 1978

UNITED STATES OF AMERICA, PETITIONER

v.

NEIL T. NAFTALIN

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

WADE H. MCCREE, JR.
Solicitor General
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Washington, D.C. 20530

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REPLY BRIEF FOR THE UNITED STATES

There is no disagreement about the facts relevant to the question of statutory interpretation presented in this case. Respondent does not deny that, by falsely representing that he owned the stock that he sold, he defrauded the brokers who executed his sales (Br. 7-8, 11), and he does not dispute that the brokers suffered financial injury as a result of his fraudulent scheme (Br. 10, 12).

Respondent correctly points out that the brokers initially covered his short sales with borrowed securities (Br. 9). Under SEC Rule 10a-2, 17 C.F.R. 240.10a-2, a seller's broker may make delivery on the settlement date with borrowed securities if he is informed that the securities are in transit to him or will be forwarded by the seller without undue delay. See II L. Loss, *Securities Regulation* 1233 (1961 ed.); see also New York Stock Exchange Rule

440B.17, 2 CCH New York Stock Exchange Guide para. 2440B.17. But as soon as the broker learns that his customer is unable to make delivery, he must "buy in" the shares. *Ibid.*[1] That is precisely what occurred here. Respondent's brokers covered his position with borrowed securities and bought in when they learned that he was short. Respondent does not quarrel with the proposition that this covering process served to insure investors against his failure to deliver.[2] He argues, however, that this insurance device insulated him from criminal liability under Section 17(a)(1) for his fraud.

I

Respondent argues that Section 17(a)(1) does not extend to the fraud that he admittedly practiced because he injured broker-agents rather than purchasers (Br. 17-19). He contends that a fraud cannot occur "in" a sale or offer unless it injures a purchaser. But respondent's frauds occurred "in" sales even if their harmful effects did

[1]If the broker has not previously forwarded borrowed securities, the securities that he "buys in" must be sent to the purchaser's broker.

[2]That is not to say that respondent's scheme did not expose investors to additional risk. See pages 23-27 of our opening brief. Had respondent's brokers been unable to cover, a "fail to deliver" would have resulted. In December 1968 "fails to deliver" of New York Stock Exchange member firms, resulting from various causes, exceeded $4 billion worth of securities. See *Clearance and Settlement of Securities Transactions: Hearings on S. 3412, etc. Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing and Urban Affairs*, 92d Cong., 2d Sess. 94-96 (1972). Prior to the establishment of the Securities Investor Protection Corporation in 1970 (see 15 U.S.C. 78aaa *et seq.*), purchasers were exposed to the risk that they would not receive their shares if brokers became insolvent and were unable to cover outstanding sales. See *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412, 415 (1975). See also SEC *Report of Special Study of Securities Markets*, H. R. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess. 418 (1963); *Bradford National Clearing Corp.* v. *SEC*, No. 77-1119 (D.C. Cir. Sept. 19, 1978), slip op. 4-5.

not reach investors. As respondent admits, he committed deception through communications of the following nature: "Sell long 1,000 Burroughs at market for Naftalin & Company" (Br. 8). His company was not "long" in this security when he made the statement (Br. 7). In these circumstances, the ordinary meaning of the words of the statute compel the conclusion that a misrepresentation occurred "in" respondent's sale. He ordered brokers to sell and committed fraud in the process.

The statute prohibits the use of all schemes to defraud in a sale or offer of a security. The term "sale" includes "every * * * disposition * * * of a security * * * for value." 15 U.S.C. 77b(3). Where, as here, a customer deceives a broker in the process of disposing of a security, the statute has been violated. If there were any doubt about the coverage of the statute, the definition of "offer" would remove it: "offer" embraces "every attempt * * * to dispose of * * * a security * * * for value." An order to a broker to sell securities is an attempt to dispose of them, and, without more, is an offer within the meaning of the statute. If the customer practices deception in placing the order, fraud occurs in an offer, in violation of the statute.[3]

The fact that brokers serve as agents does not alter the fact that they participate in sales and offers. As the district court pointed out, there is "privity" of dealing between a seller and his broker (A. 25). The broker acts for the seller in disposing of the shares; the seller acts through his broker. It should make little difference, in determining whether a fraud occurs "in" an offer or sale, whether the seller bilks the broker or the buyer. In sales through brokers, the broker has

[3]The indictment charged respondent with fraud in securities offers, as well as sales, and the district court specifically found that "[a]s to each count of the indictment * * * the defendant acted as charged" (Pet. App. 20a). Respondent is therefore mistaken in contending (Br. 18 n.31) that the district court "found only fraud in the 'sale' of securities."

an active role. He receives and executes sell orders and confirms the transactions in written communications to the seller. See 17 C.F.R. 240.10b-10; Model U.C.C. §8-319(a), (c) (1972 ed.). The seller satisfies his delivery obligation by presenting securities to the broker (Model U.C.C. §8-314), and the broker must make payment after tender of the securities on the settlement date. Moreover, under the SEC's covering rules, the seller's broker, obliged to make delivery to the purchaser's broker if the seller fails to deliver, sustains many of the risks of the trading process. In these circumstances, it is difficult to understand the argument that fraud practiced by customers on brokers during the selling process does not occur "in" an offer or sale.

II

Respondent asserts (Br. 19-22) that because Section 17(a)(3) of the Act is limited to fraud that operates on purchasers, this limitation should be read into Section 17(a)(1). The short answer to that contention is that Congress has written the law differently. Section 17(a) proscribes three categories of misconduct, and each subsection has its own coverage.[4] Subsection (3) forbids practices that defraud purchasers. Subsection (1), in contrast, forbids all fraudulent devices, without limitation on the class of victims. There is no justification for applying the purchaser limitation under subsection (1), where it has been omitted. As the district court pointed out (A. 25):

[4]Respondent asserts that if the three subsections of Section 17(a) had not been separately enumerated, and the expression "fraud * * * upon * * * the purchaser" had been made applicable to each subsection, the statute, "with minor grammatical corrections," would read as it "should" read (Br. 20). This line of argument appears to concede that the statute, as actually written by Congress, will not support the interpretation offered by respondent.

> Reading §17(a) literally, only subdivision (3) requires that the defrauded party be a purchaser. The acts specified in each subdivision are separate and distinct; each is an "allowable unit of prosecution."

See also *United States* v. *Birrell*, 266 F. Supp. 539, 543 (S.D.N.Y. 1967).

This Court's decision in *United States* v. *Gilliland*, 312 U.S. 86, 93 (1941), establishes that general antifraud provisions should not be read narrowly merely because more limited antifraud provisions also are contained in the statute. *Gilliland* involved a prosecution under a provision of the Criminal Code (52 Stat. 197) that prohibited any person to "falsify or conceal or cover up by any trick, scheme, or device a material fact, or make or cause to be made any false or fraudulent statements" in reports filed with government agencies. The provision also prohibited the submission of any bill or voucher falsely claiming money from the government. The defendant in *Gilliland* contended that the general prohibition should be limited to the subject matter of the narrower prohibition, and that the statute should be confined to cases involving pecuniary injury to the government. This Court rejected the proposed application of the doctrine of ejusdem generis, explaining:

> The rule of *ejusdem generis* is a familiar and useful one in interpreting words by the association in which they are found, but it gives no warrant for narrowing alternative provisions which the legislature has adopted with the purpose of affording added safeguards.

Id. at 93. See also *United States* v. *Alpers*, 338 U.S. 680, 682-684 (1950), pointing out that the doctrine of ejusdem generis cannot be used to render general provisions meaningless, especially where the legislature has intended to adopt a "comprehensive" remedial statute. There can be no doubt that the antifraud provisions of the securities laws were

intended to serve broad remedial purposes (see page 21 of our opening brief) and respondent's restrictive interpretation would frustrate those purposes.[5]

III

Respondent refers to legislative history showing that Congress intended to protect investors when it enacted the Securities Act of 1933 (Br. 22-26), and asks the Court to infer that this was the sole purpose. But respondent has not found a single piece of legislative history that suggests that investor protection was the exclusive purpose, or that Congress was not concerned with frauds causing injury to business.[6] The legislative history shows beyond genuine

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[5]Of course, rules of construction such as ejusdem generis ("of the same kind") or noscitur a sociis ("known by association") may bear on the question whether a term in a statute qualifies or limits preceding terms. But rules of construction must always be used to implement the purpose of the statute and the intention of the legislature. See, *e.g.*, *Porto Rico Ry.* v. *Mor*, 253 U.S. 345 (1920); *FMC* v. *Seatrain Lines, Inc.*, 411 U.S. 726 (1973). Such rules "long have been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose * * *." *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 350-351 (1943). They may not be applied to distort a statute. See *Costanzo* v. *Tillinghast*, 287 U.S. 341, 344 (1932) ("since the phrase [in question] has a proper office in qualification of the class specified in the clause in which it appears, its effect should be limited to that class and not carried over to the others").

[6]The cases relied on by respondent are as unhelpful to him as is the legislative history. It is true that both *United States* v. *Ashdown*, 509 F. 2d 793 (5th Cir. 1975), and *United States* v. *Schaefer*, 299 F. 2d 625 (7th Cir. 1962), state that in prosecutions under Section 17(a) the government must show an "impact" on investors arising from the use of the mails. But these courts did not use the term "impact" as the equivalent of "financial loss." In those cases, there was no question that investors had suffered losses; the issue was "whether the mailings were sufficiently related to the scheme to provide a federal jurisdictional base." *Ashdown*, *supra*, 509 F. 2d at 798; see also *Schaefer*, *supra*, 299 F. 2d at 629-630. In both cases the courts held that the government met its burden when it proved that the use of the mail was more than incidentally related to the fraudulent scheme. Neither court addressed the question whether Section 17(a) would be violated if someone other than an investor suffered injury.

question that Congress adopted the Securities Act of 1933 as part of the national effort to correct abuses that contributed to the collapse of the economy during the Depression. Congress believed that honesty in securities transactions would help to restore economic health by protecting the interests of both investors and businesses. See S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933); H.R. Rep. No. 85, 73d Cong., 1st Sess. 2-3 (1933).[7] Because Congress intended to protect the national economy by prohibiting all forms of fraud in securities offers and sales, the legislative history provides no basis for adopting the narrow construction urged by respondent.[8]

Respondent also argues that the 1933 Act was "preoccupied with the regulation of public offerings of securities" and was not directed to trading in securities in the "aftermarket" (Br. 23). The Securities Exchange Act of 1934, of course, provides pervasive regulation of transactions in the aftermarket. But Section 17(a) of the Securities Act of 1933 also governs such trading. That Section extends to any fraudulent scheme in an offer or sale of securities, not just to schemes occurring in primary distributions. As the House Report points out, the 1933 Act

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[7]There is nothing "isolated" or "oblique" (Br. 25) about these references to business injury. See Pet. Br. 16-21.

[8]The law review article cited by respondent (Br. 25), Herlands, *Criminal Law Aspects of the Securities Act of 1933*, 67 U.S. L. Rev. 562, 571 (1933), points out that Section 17(a) "adopts almost verbatim the language of the mail fraud statute." That statute (18 U.S.C. 1341) forbids all fraudulent schemes practiced through the mails. See, *e.g.*, *United States* v. *Netterville*, 553 F. 2d 903, 909 (5th Cir. 1977), cert. denied, 434 U.S. 1009 (1978); *United States* v. *Serlin*, 538 F. 2d 737, 744 (7th Cir. 1976). See also *Durland* v. *United States*, 161 U.S. 306, 313-314 (1896). There is no limitation on the class of victims under the mail fraud statute, just as there is no limitation under Section 17(a)(1). The object of both statutes is to prohibit fraud in the regulated medium—in the one case, the mails; in the other, offers and sales of securities.

prohibits "any device, scheme, or artifice to defraud, employed in connection with the sale in interstate or foreign commerce of any securities, *whether new or already outstanding*." H.R. Rep No. 85, *supra*, at 6 (emphasis added). This Court has observed that Section 17(a) applies to insider trading activities in the aftermarket. See *Foremost-McKesson* v. *Provident Securities Co.*, 423 U.S. 232, 255 (1976). And it clearly applies to broker-dealer transactions in the aftermarket. See III Loss, *supra*, at 1428. See also *Charles Hughes & Co.* v. *SEC*, 139 F. 2d 434, 435-438 (2d Cir. 1943); *Mawod & Co.* v. *SEC*, No. 77-1495 (10th Cir. Jan. 24, 1979).

IV

Respondent finally contends (Br. 26-32) that Section 17(a)(1) is inapplicable here because short selling is regulated by Section 10(a), and fraud in connection with a purchase or sale of a security by Section 10(b), of the Securities Exchange Act of 1934, 15 U.S.C. 78j. But the indictment charges respondent with fraud in the offer and sale of securities, which is precisely what Section 17(a)(1) prohibits. The government properly relied on Section 17(a)(1) to reach fraud in both an *offer* and sale because, in that respect, Section 17(a) reads more broadly than Section 10(b) (*Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 733-734 (1975)). Because, moreover, the substance of the charge was fraud, and not simply failure to comply with rules regulating short selling, the government was not required to proceed under Section 10(a).

The fact that respondent's conduct may have violated other provisions of the federal securities laws in addition to Section 17(a)(1) is not material. See *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969) ("the existence or nonexistence of regulation under §14 would not affect the scope of §10(b) * * *. The fact that there may well be some overlap is neither unusual nor unfortunate"). See also *Edwards* v. *United States*, 312 U.S. 473, 483-484

(1941), holding that both Section 17(a) and the federal mail fraud statute may properly be applied to fraudulent securities sales and noting that "[t]he two can exist and be useful, side by side." Accord, III Loss, *supra*, at 1428. As this Court has pointed out, "so long as the prosecutor has probable cause to believe that the accused committed an offense defined by statute, the decision whether or not to prosecute, and what charge to file or bring before a grand jury, generally rests entirely in his discretion." *Bordenkircher* v. *Hayes*, 434 U.S. 357, 364 (1978); see also *United States* v. *Beacon Brass Co.*, 344 U.S. 43, 45-46 (1952).[9]

For the foregoing reasons, and those set forth in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

MARCH 1979

[9]The scope of the prosecutor's discretion to elect among applicable criminal law provisions in seeking an indictment is discussed in greater detail on pages 35-41 of our brief in *United States* v. *Batchelder*, No. 78-776, cert. granted (Jan. 8, 1979), a copy of which has been furnished to counsel for respondent.